No. 92-641-CFX
Status: GRANTED

Title: Leonard Nobelman, et ux., Petitioners
v.
American Savings Bank, et al.

Docketed:
October 13, 1992

Court: United States Court of Appeals for the Fifth Circuit

Counsel for petitioner: Palmer Jr.,Philip I.

Counsel for respondent: Schroeder,Michael J., Kennon III,Charles L.

Entry	Date	Note	Proceedings and Orders
1	Oct 13 1992	G	Petition for writ of certiorari filed.
2	Nov 12 1992		Brief of respondent American Savings Bank in opposition filed.
3	Nov 12 1992		Brief amici curiae of Federal Home Loan Mortgagae Corp., et al. filed.
4	Nov 18 1992		DISTRIBUTED. December 4, 1992
5	Dec 7 1992		Petition GRANTED.
			**********
6	Dec 23 1992		Record filed.
		*	Partial proceedings United States Court of Appeals for the Fifth Circuit.
7	Dec 29 1992		Record filed.
		*	Certified proceedings United States District Court, Northern District of Texas.
8	Jan 15 1993		Brief amicus curiae of Harold J. Barkley, Jr. filed.
9	Jan 19 1993		Brief amici curiae of Consumer Education and Protective Association, et al. filed.
10	Jan 21 1993		Joint appendix filed.
11	Jan 21 1993		Brief of petitioners Leonard Nobelman, et ux. filed.
12	Feb 19 1993		Brief amicus curiae of Federal Home Loan Mortgage Corp. filed.
14	Feb 19 1993		Brief amicus curiae of Alaska filed.
13	Feb 22 1993		Brief amicus curiae of Federal National Mortgage Association filed.
15	Feb 22 1993		Brief amici curiae of American Bankers Association, et al. filed.
16	Feb 22 1993		Brief amicus curiae of Mortgage Bankers Association of America filed.
17	Feb 22 1993		Brief amicus curiae of National Association of Realtors, et al. filed.
21	Feb 22 1993		Brief amicus curiae of Nationsbanc Mortgage Corporation filed.
18	Feb 23 1993		Brief of respondent American Savings Bank, F.A. filed.
19	Feb 24 1993		Brief of respondent Molly Bartholow, Standing Chapter 13 Trustee filed.
22	Mar 4 1993		CIRCULATED.
23	Mar 5 1993		SET FOR ARGUMENT MONDAY, APRIL 19, 1993. (3RD CASE).
24	Apr 19 1993		ARGUED.

92-641

Supreme Court, U.S.
FILED
OCT 13 1992
OFFICE OF THE CLERK

No. _____

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

May debtors in a Chapter 13 bankruptcy case use 11 U.S.C. Section 506(a) to reduce the secured claim upon their residence to fair market value and treat the balance as an unsecured claim without violation of 11 U.S.C. Section 1322(b)(2)?

LIST OF ALL PARTIES TO THE PROCEEDINGS

Petitioners and Appellants below:

Leonard Nobelman and wife, Harriet Nobelman (misspelled "Nobleman" in Court of Appeals)

Respondent and Appellee below:

Tim N. Truman, Standing Chapter 13 Trustee for the Northern District of Texas

American Savings Bank:

Parent: If any, unknown

Non-wholly owned subsidiaries: If any, unknown

Murray Mortgage Company:

Parent: If any, unknown

Non-wholly owned subsidiaries: If any, unknown

REFERENCE TO OFFICIAL AND UNOFFICIAL REPORTS BY OTHER COURTS

Case Below:

Matter of Nobleman, 968 F.2d 483 (5th Cir. 1992)

Re Nobelman, 129 B.R. 98 (D.C. N.D. Tex. 1991)

STATEMENT OF THE GROUNDS UPON WHICH JURISDICTION OF THE SUPREME COURT IS BASED

Judgment of the Court of Appeals below was entered August 13, 1992.

Petition for Certiorari is sought within 90 days of entry of Final Judgment by Court of Appeals giving jurisdiction under 28 U.S.C. Section 1254(2) and Supreme Court Rule 13.1.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED IN THIS CASE

Article II, Section 8, Constitution of the United States:

> (The Congress shall have Power) "To establish a uniform Rule of Naturalization and uniform Laws on the subject of Bankruptcies throughout the United States."

Title 11, U.S.C. Section 103(a):

> "Except as provided in section 1161 of this title, Chapters 1, 3, and 5 of this title apply in a case under Chapters 7, 11, 12, or 13 of this title."

Title 11, U.S.C. 506(a):

"An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."

Title 11, U.S.C. Section 1322(b)(2):

(b) "Subject to subsections (a) and (c) of this section, the plan may –

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims."

STATEMENT OF THE FACTS OF THE CASE

The Nobelmans' residence is a condominium with a fair market value of $23,500, although secured by a lien in the total amount of $71,335.04. In their Chapter 13 Plan of

Debt Adjustment, the Nobelmans propose to value down the secured claim to the fair market value and treat the balance as an unsecured claim under a technique commonly called "lien splitting." That effort thus far has been denied by all courts below.

BASIS OF JURISDICTION IN THE COURT OF APPEALS

Petitioners presented a Final Order of the District Court affirming a Final Order of the Bankruptcy Judge, giving the Court of Appeals jurisdiction under 28 U.S.C. Section 158(d).

ARGUMENT ON REASONS FOR GRANTING WRIT OF CERTIORARI

1. CONFLICT AMONG CIRCUITS.

The Court of Appeals for the Fifth Circuit, in its opinion, acknowledges that its opinion is in conflict with four other circuit court opinions, specifically, *Bellamy v. Federal Home Loan Mortgage Co.*, 962 F.2d 176 (2nd Cir. 1992); *In re Hart*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3rd Cir. 1990); and *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989). See *Matter of Nobleman*, 968 F.2d 483, 486 (5th Cir. 1992).

The Nobelman opinion also conflicts with the Third Circuit opinion in *Sapos v. Provident Inst. of Savings*, 967 F.2d 918 (3rd Cir. 1992), which it does not mention.

2. IMPORTANT QUESTION OF A UNITED STATES COURT OF APPEALS WHICH SHOULD BE SETTLED BY THIS COURT.

Article I, Section 8, of the U.S. Constitution requires uniform laws on bankruptcy. While the statutes involved read the same, they are not being uniformly applied because of the split in the circuits. At the time this Petition is prepared, a Chapter 13 debtor may split residence liens in four circuits covering 17 states, but may not do so in three states. The remaining six circuits have not yet passed upon the issue.

This Court's recent opinion of *Dewsnup v. Timm*, ___ U.S. ___, 112 S.Ct. 773, 116 L. Ed. 2d 903 (1992), has lead to some confusion in this area, as predicted by the dissent, even though it dealt with a Chapter 7 liquidation and stated it was to be restricted to its facts. In the Chapter 13 arena, the opinion below found support in *Dewsnup, Matter of Nobleman*, 968 F.2d 483, 487 (5th Cir. 1992), while the Second and Third Circuits found *Dewsnup* inapplicable to Chapter 13 cases. *Bellamy v. Federal Home Loan Mortgage Co.*, 962 F.2d 176, (2nd Cir. 1992); *Sapos v. Provident Inst. of Savings*, 967 F.2d 918 (3rd Cir. 1992).

It would be very helpful to bankruptcy administration for a clarification of the extent, if any, to which the teachings of *Dewsnup* should be applied in Chapter 13.

See, for example, Professor Margaret Howard, *Norton Bankr. Law Advisor*, (1992-3) (Mar. 1992) p.3, *Dew-What?*

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APPENDIX

1. Opinion of Court of Appeals for the Fifth Circuit sought to be reviewed, *Matter of Nobleman*, 968 F.2d 483 (5th Cir. 1992).....App. 1

2. *In re Nobelman*, 129 B.R. 98 (N.D. Tex. 1991)..... App. 16

3. *In re Nobelman*, 390-35116-HCA-13 (B.C. N.D. Tex. 1991) (unreported)..... App. 32

In the Matter of Leonard NOBLEMAN and Harriet Nobleman, Debtors.

Leonard NOBLEMAN and Harriet Nobleman, Appellants,

v.

AMERICAN SAVINGS BANK and Tim Truman, Standing Chapter 13 Trustee, Appellees.

No. 91-1796.

United States Court of Appeals, Fifth Circuit.

Aug. 13, 1992.

Philip Palmer, Jr., Dallas, Tex., for debtors, appellants Leonard and Harriet Nobleman.

Terre M. Vardaman, Jackson, Miss., for amicus curiae Harold J. Barkley.

Michael J. Schroeder, David M. Odens, Settle & Pou, Dallas, Tex., for appellee American Sav. Bank.

Charles Kennon, Fort Worth, Tex., for appellee Tim Truman.

Dean Cooper, Assoc. Gen. Counsel, FHLMC, McLean, Va., for amicus curiae Federal Home Loan Mortg. Corp.

Michael L. Riddle, Dallas, Tex., for amicus curiae Mortg. Bankers Ass'n of America.

Appeal from the United States District Court For the Northern District of Texas.

Before BROWN, GARWOOD and EMILIO M. GARZA, Circuit Judges.

EMILIO M. GARZA, Circuit Judge:

The United States Bankruptcy Court for the Northern District of Texas denied confirmation of the Chapter 13 reorganization plan proposed by Leonard and Harriet Nobleman, in which the Noblemans attempted to bifurcate a mortgage lien claim on their principal residence into secured and unsecured claims. The United States District Court for the Northern District of Texas affirmed the decision of the bankruptcy court. *See* 129 B.R. 98 (N.D.Tex.1991). The Noblemans appeal, and, finding that the use of 11 U.S.C. § 506[1] to bifurcate this claim would impermissibly modify the rights of American Savings Bank under 11 U.S.C. § 1322(b)(2).[2] we affirm the order of the district court.

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[1] Section 506(a) of Title 11 provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff . . . and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim.

[2] Section 1322(b)(2) of Title 11 provides that the Chapter 13 plan may:

> modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

I

The facts of this case are uncontested. The Noblemans executed a note in the amount of $68,250.00, payable to American Savings Bank (American), and secured by a deed of trust on their principal residence – a condominium in a complex in Dallas, Texas.[3] Six years later, the Noblemans filed a voluntary petition for relief under Chapter 13 of the bankruptcy code. American filed its proof of claim for $71,265.04 – which was later amended to $71,335.04. The Noblemans then filed an initial and modified Chapter 13 Plan of Reorganization. The plan valued the Noblemans' residence at $23,500.00. The Noblemans also filed a motion for valuation pursuant to 11 U.S.C. § 506 along with certain modifications to their plan. At the confirmation hearing, Mr. Nobleman testified as to the value of the property; no controverting evidence of its value was offered by any other party.

In their modified plan, the Noblemans proposed to make direct payments to American at the mortgage contract rate only up to the scheduled value of the condominium. The balance of American's claim – $41,257.66 – would be treated as a general unsecured claim under the Plan, payable *pari passu*, though the Noblemans did plan to cure the prepetition arrearages owed to American. The unsecured creditors would receive nothing.

---

[3] The deed of trust also provided for a security interest in an undivided .67% interest in the common areas of the condominium complex, escrow funds, proceeds of hazard insurance, and rents.

Both American and the Standing Chapter 13 Trustee objected to the confirmation of the plan on the grounds that, inter alia, the plan purported to alter the lienholders' rights in violation of 11 U.S.C. § 1322(b)(2). The bankruptcy court found that the plan impermissibly proposed to modify American's rights by bifurcating American's claim into secured and unsecured claims in violation of 11 U.S.C. § 1322(b)(2). Accordingly, the bankruptcy court denied confirmation of the Noblemans' modified Chapter 13 plan, and the district court affirmed.[4]

II

The parties and their amici are not in agreement regarding the approach we should take in interpreting the interplay between sections 506(a) and 1322(b)(2) of the bankruptcy code. The Noblemans concede that a debtor may not modify the rights of holders of a secured claim if such security is an interest in real property that is the debtor's principal residence. They assert, however, that section 506(a) defines a secured claim as the value of the collateral, while any balance on the debt above this amount is an unsecured claim. Thus, they contend that, under section 1322(b)(2), the only portion of a claim which cannot be modified is the part supported by the value of the collateral – the secured claim. The part of the

[4] The bankruptcy court's conclusion of law – that the modified plan violated 11 U.S.C. § 1332(b)(2) – is subject to plenary review on appeal. *See In re Delta Towers, Ltd.*, 924 F.2d 74, 76 (5th Cir.1991) (quotations omitted); *In re Allison*, 960 F.2d 481, 483 (5th Cir.1992) (citations omitted).

claim in excess of the value of the collateral becomes an unsecured claim, which can be modified.

One amicus suggests that allowing debtors to bifurcate a mortgage lien claim pursuant to section 506 and allowing a modification pursuant to section 1322(b)(2) results in a systematic and coherent application of the bankruptcy code. It further argues that to prohibit the bifurcation of a claim would ignore that various sections of the bankruptcy code are to be read together.

American, on the other hand, contends that the proposed modification of the Noblemans' Chapter 13 plan is impermissible because it would bifurcate the creditor's claim into secured and unsecured claims. American asserts that bifurcation of a secured claim in real property that is the debtor's principal residence violates section 1322(b)(2) because the plan meaning of section 1322(b)(2) prohibits such a modification. Furthermore, American contends that the general provisions of section 506 must not be read to prevail over the specific provisions of section 1322(b)(2), because the general language of one section should not control matters specifically addressed in another. American also argues that the limited bar regarding modification of the rights of residential lenders was enacted in response to Congressional perceptions that these lenders perform a valuable social purpose by making home loans.

Two other amici agree with American, contending that bifurcating a debtor's secured claim under section 1322(b)(2) is unfair and unworkable because bifurcation: (i) provides a windfall to Chapter 13 debtors; (ii) results in home mortgage lenders receiving worse treatment

under Chapter 13 than other secured creditors; and (iii) does not help promote the bankruptcy code's fresh start objective. Furthermore, the amici argue that the plain meaning of section 1322(b)(2) precludes a debtor from "cramming down"[5] a claim secured only by the debtor's principal residence, and that the rights of holders of secured claims, which include a claim secured only by a security interest in property that is the debtor's principal residence, may not be modified.

III

The foregoing summary of the different positions of the parties and their amici demonstrates that the interplay between sections 506 and 1322(b)(2) of the bankruptcy code is not entirely clear.

A

Four circuit courts have adopted the position advocated by the Noblemans, allowing bifurcation of an undersecured mortgage into a secured portion and an unsecured portion. In *Bellamy v. Federal Home Loan Mortgage*, 962 F.2d 176, 179-180 (2d Cir.1992), the Second Circuit discussed sections 506(a) and 1322(b)(2), and reasoned that a claim must first be analyzed under section 506(a) to determine the part that is fully secured – that is, the amount equal to the market value of the

[5] Cram-down is a term which refers to an attempt by a Chapter 13 debtor to reduce a secured claim to the value of the collateral securing the claim and to discharge the balance as an unsecured claim under the Chapter 13 plan.

property on which the lien is fixed. The balance of the claim owed above the market value is unsecured. *Id.* Bifurcating a claim into secured and unsecured portion does not, for purposes of section 1322(b)(2), modify the creditor's rights, but rather determines how, under the bankruptcy code, the creditor's right to payment must be satisfied. *Id.* at 179-180. The Third, Ninth, and Tenth Circuits have held similarly. *See In re Hart*, 923 F.2d 1410, 1411 (10th Cir.1991) (bifurcation of a home mortgage into secured and unsecured portions based on the fair market value of the property under a threshold application of section 506(a) was a recognition of the legal status of the creditor's interest in the debtors' property and not a modification of the mortgage); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 126-29 (3d Cir.1990) (unsecured portion of creditor's claim may be modified, and anti-modification provision of section 1322(b)(2) does not apply because creditor's claim was secured by personal property as well as by debtor's residence)[6]; *In re Hougland*, 886 F.2d 1182, 1183 (9th Cir.1989) (nothing in section 1322(b)(2) affects the determination under section

[6] In *Sapos v. Provident Inst. of Sav. in the Town of Boston*, 967 F.2d 918, 920 (3d Cir. 1992), the Third Circuit affirmed its holding in *Wilson*, The Third Circuit noted the Supreme Court's holding in *Dewsnup v. Timm*, ___ U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), and stated that the *Dewsnup* Court's "interpretation of section 506 in a chapter 7 liquidation does not apply in this chapter 13 reorganization." *Id.* at 925. The Third Circuit concluded that "a Chapter 13 debtor with an undersecured debt, whether that debt be secured solely by residential real estate or by realty and personality, may resort to bifurcation under section 506(a). . . ." *Id.* at 928.

506(a) that an undersecured claim can be divided into a secured portion and an unsecured portion).

Bankruptcy courts, including some in this circuit and the First, Sixth, Seventh, Eighth and Eleventh circuits, have adopted the position advocated by American. These courts that have held bifurcation impermissible because such bifurcation would vitiate the purpose of section 1322(b)(2). *See, e.g., In re Chavez,* 117 B.R. 733, 736 (Bankr.S.D.Fla.1990) (in a Chapter 13 case, the allowed amount of a claim secured only by a security interest in a principal residence of a debtor is, at filing, the balance owing on the debt without regard to the value of the collateral, section 506(a) notwithstanding); *In re Kaczmarczyk,* 107 B.R. 200, 202 (Bankr.D.Neb.1989) (section 1322(b)(2) claims should not be bifurcated). In *In re Boullion,* 123 B.R. 549, 551 (Bankr.W.D.Tex.1990), the bankruptcy court discussed the interplay between sections 1322(b)(2) and 506(a), and stated that "in view of *Grubbs' [v. Houston First Am. Sav. Ass'n,* 730 F.2d 236 (5th Cir. 1984) (en banc)] interpretation of the intention of Congress in enacting § 1322(b)(2), applying 11 U.S.C. § 506 to these secured claims would result in a 'modification' in contravention of the clear meaning of the statute." Similarly, in *In re Schum,* 112 B.R. 159, 162 (Bankr.N.D.Tex.1990), the bankruptcy court held that the "proposed modification of the debt would have the effect of treating the real property secured by only a lien on the debtor's principal residence in the same manner as any other property secured by a lien."[7]

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[7] *See also In re Sauber,* 115 B.R. 197 (Bankr.D.Minn.1990). In *Sauber,* the bankruptcy court denied the confirmation of a debtor's Chapter 13 plan that proposed to divide the first mortgage into secured and unsecured portions. *Id.* at 199. The *Sauber* court stated that "[t]he Ninth Circuit, in *Hougland,* takes an overly technocratic approach in analyzing the language of § 1322(b)(2) . . . and in relating § 506(a) to it." *Id.* The *Sauber* court reasoned that by focusing on the terms "secured claim" and "unsecured claim", and by using section 506(a) definitions, the *Hougland* court judicially removed most of the protection that the statute provides. *Id.*

Similarly, in *In re Mitchell,* 125 B.R. 5, 6 (Bankr.D.N.H.1991) the court stated that the specific language of section 1322(b)(2) prevails over the general language of section 506(a). To support this conclusion, the *Mitchell* court noted that if Congress had intended to change the manner in which a claim secured by a debtor's residence would be treated under the bankruptcy code, Congress would have specifically limited section 1322(b)(2) to claims secured pursuant to section 506. *Id.* at 8; *see also In re Etchin,* 128 B.R. 662, 665 (Bankr.W.D.Wis.1991) (bifurcation and partial avoidance of an undersecured home mortgage by a Chapter 13 debtor runs afoul of the specific protection afforded to creditors whose claims are secured only by a debtor's principal residence under § 1322(b)(2)); *In re Bradshaw,* 56 B.R. 742, 747 (S.D.Ohio 1985) (section 1322(b)(2) prevents modification of any loan secured only by a security interest in the debtor's principal residence).

B

The Supreme Court's recent decision in *Dewsnup v. Timm,* ___ U.S. ___, 112 S.Ct. 773, 775, 116 L.Ed.2d 903 (1992), lends support to this view that bifurcation is impermissible. In *Dewsnup,* the Court had to decide whether, under 11 U.S.C. § 506(d) of the bankruptcy code, a debtor could "strip down" a creditor's lien on real property to the value of the collateral, when that value is less than the amount of the claim secured by the lien. The Court held that section "506(d) does not allow petitioner

to 'strip down' respondents' lien, because respondents' claim is secured by a lien and has been fully allowed pursuant to § 502." *Id.*, ___ U.S. at ___, 112 S.Ct. at 778. The Court specifically stated that it took no position on the meaning of the words "allowed secured claim" in other provisions of the bankruptcy code, specifically section 506(a).[8] *Id.*, ___ U.S. at ___, 112 S.Ct. at 778, n. 3. The Court declared that "to grant a debtor the broad new remedy against allowed claims to the extent that they become 'unsecured' for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles." *Id.*, ___ U.S. at ___, 112 S.Ct. at 779. The Court reasoned that the creditor's lien stays with the real property until foreclosure because that "is what was bargained for by the mortgagor and the mortgagee." *Id.* ___ U.S. at ___, 112 S.Ct. at 778. "Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed. . . . " *Id.*

C

In our analysis, we are cognizant that "[t]he plain meaning of legislation should be conclusive, except in the

[8] *See Patterson v. Shumate*, ___ U.S. ___, ___ 112 S.Ct. 2242, 2251, 119 L.Ed.2d 519 (1992) (Scalia, J., concurring) (noting the one-subsection-at-a-time approach taken by *Dewsnup* Court when interpreting section 506(d) of Title 11 of the bankruptcy code).

'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.' " *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242, 109 S.Ct. 1026, 1031, 103 L.Ed.2d 290 (1989) (quotation omitted). The words of the statute "are the primary, and ordinarily the most reliable, source of interpreting the meaning of any writing. . . . " *Watt v. Alaska*, 451 U.S. 259, 266, n. 9, 101 S.Ct. 1673, 1678, n. 9, 68 L.Ed.2d 80 (1981) (quotation omitted). Section 506(a) of Title 11 provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff . . . and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim.

Section 506(a) is a provision of general applicability in cases under Chapter 7, 11, 12 and 13 of the bankruptcy code. *See* 11 U.S.C. § 103(a). Section 1322(b)(2) of Title 11, however, only applies in Chapter 13 cases. *See* 11 U.S.C. § 103(h). Section 1322(b)(2) provides that the Chapter 13 plan may:

> modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

Section 1322(b)(2) clearly prohibits the modification of rights of holders of secured claims if the claim is secured only by a security interest in the debtors' principal residence. However, this prohibition set forth in section 1322(b)(2) appears to conflict with section 506(a), which would allow the modification. If two statutes conflict, a generally accepted tenet of statutory construction is that the general language of a statute does not "prevail over matters specifically dealt with in another part of the same enactment." *See In re Russell*, 93 B.R. 703, 705 (D.N.D.1988) (citations omitted); *see also Landmark Land Co. v. Office of Thrift Supervision*, 948 F.2d 910, 912 (5th Cir.1991), *quoting Gozlon-Peretz v. United States*, ___ U.S. ___, 111 S.Ct. 840, 848, 112 L.Ed.2d 919 (1991) (citation omitted) (a specific provision controls over one of more general application); *Mennor v. Fort Hood Nat'l Bank*, 829 F.2d 553, 557 (5th Cir. 1987) ("The general language in a statute such as 42 U.S.C. § 2000e-5(k) may not be interpreted to authorize what is disallowed by the specific language of 28 U.S.C. § 1920"); *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204, 208, 52 S.Ct. 322, 323, 76 L.Ed. 704 (1932) (general language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment). We accordingly hold that the specific language of section 1322(b)(2) prevails over the general language of section 506(a).

Moreover, section 1322(b)(2) describes its subject matter as the modification of "the *rights of holders* of" claims, not as the modification of *claims* as such; thus, the section can properly be read as *excepting* from its reach modification of "*the rights of holders of* . . . a claim secured

only by a security interest in real property that is the debtor's principal residence. . . . " Therefore, even if the entirety of such a claim is not a secured claim (as per section 506(a)), the rights of a holder of such a claim may not be modified under section 1322(b)(2).

D

The legislative history also indicates that Congress intended this result. In *Grubbs v. Houston First Am. Sav. Ass'n*, we discussed section 1332(b)(2)'s legislative history and noted:

> With regard to § 1322(b)(2), the Senate receded from its position that no "modification" was to be permitted of *any* mortgage secured by real estate; it instead agreed to a provision that modification was to be barred *only* as to a claim "secured only by a security interest in real property *that is the debtor's principal residence.*" This limited bar was apparently in response to perception, or in suggestions advanced to the legislative hearings . . . that, home-mortgagor lenders, performing a valuable social service through their loans, needed special protection against modification. . . .

730 F.2d 236, 246 (5th Cir.1984) (en banc) (emphasis supplied in *Grubbs*.)

In *Grubbs* we held that section 1322(b), "construed in the light of its legislative history and of its context within Chapter 13 . . . evinces no legislative intent that a home-mortgagor debtor is barred either (a) from curing a pre-

petition acceleration into maturity of the unpaid installments due upon his home mortgage, or (b) from proposing . . . that all past due or matured amounts secured by his home mortgage be paid during the term of his plan. . . . " *Id.* at 237. Therefore, although our holding in *Grubbs* did not specifically deal with the interplay between section 506(a) and section 1322(b)(2) of Title 11 of the bankruptcy code, we did discuss the legislative history of section 1322(b)(2) and noted the legislative intent not to permit any modification on a claim secured by the debtor's principal residence.

We are persuaded that our analysis of section 506(a) and section 1322(b)(2) is consistent with the legislative history of section 1322(b)(2) of the bankruptcy code – the desire to afford some protection to the home mortgage industry. *See Grubbs*, 730 F.2d at 245-46. As the other courts which have discussed these provisions have noted, the Senate and House versions of section 1322(b)(2) were different. The proposed House version was favorable to debtors, allowing the plan to "modify the rights of holders of secured claims or of holders of unsecured claims. . . . " *See* 3 App. *Collier on Bankruptcy* at III, 537 (15th Ed.1992). The proposed Senate version was favorable to lenders, stating that the plan could "modify the rights of holders of secured claims (other than claims wholly secured by mortgages on real property) or of holders of unsecured claims. . . . " *Id.* at VII, 572-73. Neither the Senate version nor the House version became the final version of section 1322(b)(2) – the final version was characterized by legislative leaders as a "compromise" agreement. *See* Bankruptcy Reform Act of 1978, Pub.L. No. 95-598, 1978 U.S.C.A.N. 5787, 6481, 6550

(statements of Representative Edwards and Senator DeConcini – section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate amendment). We believe our interpretation of section 506(a) and section 1322(b)(2) reflects this compromise.

Accordingly, we hold that section 1322(b)(2) prohibits confirmation of the Noblemans' Chapter 13 plan. The bifurcation of an undersecured home mortgage runs afoul of the specific protection afforded under section 1322(b)(2) to home mortgage creditors whose claims are secured only by a debtor's principal residence. Section 506(a) cannot be used to bifurcate the claim and vitiate the protection of section 1332(b)(2).

IV

For the foregoing reasons, we AFFIRM.

In re Leonard NOBELMAN and Harriet Nobelman, Debtors.

Leonard NOBELMAN and Harriet Nobelman, Appellants,

v.

AMERICAN SAVINGS BANK and Tim Truman, Trustee, Appellees.

Civ. A. No. 3-91-0753-H.

United States District Court,
N.D. Texas,
Dallas Division.

June 24, 1991.

Rosemary J. Zyne, Dallas, Tex., for debtors.

Michael Schroeder Settle & Pou, Dallas, Tex., for American Sav. Bank.

Charles L. Kennon, III, Ft. Worth, Tex., for Truman.

MEMORANDUM OPINION
AND ORDER

SANDERS, Chief Judge.

This is an appeal from a final order of the United States Bankruptcy Court of the Northern District of Texas, Dallas Division in an action brought under the United States Bankruptcy Code. The Court has jurisdiction over the appeal pursuant to 28 U.S.C. § 158(a).

The present appeal, a matter of first impression in this District, concerns the bankruptcy court's denial of confirmation of a Chapter 13 Plan of Reorganization that

used the provisions of 11 U.S.C. § 506 to bifurcate a mortgage lien claim on the principal residence of Debtors Leonard and Harriet Nobelman into allowed secured and allowed unsecured claims for purposes of treatment under the Plan. The Court concluded that using section 506 to bifurcate the claim impermissibly modified the rights of Appellee, American Savings Bank, N.A. ("ASB"), in violation of 11 U.S.C. § 1322(b)(2).

I. Background.

The facts of this case are uncontested. On June 21, 1984, the Nobelmans executed a note in the amount of $68,250.00 payable to ASB, secured by a deed of trust on their primary residence. Murray Mortgage Company is the servicing agent of ASB. The deed of trust also provides for a security interest in an undivided .67% interest in the common areas of the condominium complex, escrow funds, proceeds of hazard insurance, and rents.

On August 6, 1990, the Nobelmans filed a voluntary petition for relief under Chapter 13 of the Bankruptcy Code. On August 14, 1990, ASB filed its proof of claim for $71,265.04, which was subsequently amended to $71,335.04. ASB's proof of claim provides that ASB's claim is secured only to the extent that its security interest is sufficient to satisfy the full amount of the claim, and that it is unsecured to the extent that it is insufficient.

The Nobelmans filed their Chapter 13 Plan of Reorganization (the "Plan") on August 31, 1990, which was later modified. The Plan values the residence at $23,500.00. The Nobelmans filed a motion for valuation pursuant to 11 U.S.C. § 506 along with the modifications

to their Plan. At confirmation, Leonard Nobelman testified as to the value of the property; no controverting evidence of its value was offered by any other party.

The Plan proposes to make direct payments to ASB at the mortgage contract rate only up to the scheduled value of the collateral. The balance of ASB's claim – $41,257.66 – is treated as a general unsecured claim under the Plan, payable pari passu. The unsecured creditors receive nothing under the Plan. The Nobelmans propose to cure the prepetition arrearages owed to ASB through their Plan.

Both ASB and the Standing Chapter 13 Trustee objected to the confirmation of the Plan on the grounds that, *inter alia*, the Plan purports to alter the lienholders' rights in violation of 11 U.S.C. § 1322(b)(2).

On February 13, 1991 the Bankruptcy Court entered its findings of fact and conclusions of law. The findings of fact are undisputed and are recited above. The bankruptcy court's conclusions of law find that "[t]he Plan impermissibly proposes to modify [ASB's] claim into secured and unsecured claims in violation of § 1322(b)(2)." Findings of Fact and Conclusions of Law entered February 14, 1991, at 3. Accordingly, on March 12, 1991. The bankruptcy court entered its order denying confirmation of the Nobelman's modified Chapter 13 Plan.

On March 21, 1991, the Nobelmans filed their Notice of Appeal.

II. Standard of Review

This Court reviews the bankruptcy court's findings of fact under the clearly erroneous standard, but the bankruptcy court's conclusion of law are subject to de novo review. *See In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1252 (5th Cir.1986); *Lawler v. Guild, Hagen & Clark, Ltd. (In re Lawler)*, 106 B.R. 943, 952 (N.D.Tex.1989) [hereinafter *In re Lawler*]. Because the facts of this case are undisputed, the sole subject of review are the bankruptcy court's conclusions of law. De novo review requires the Court to make a judgment independent of the bankruptcy court's, without deference to that court's analysis and conclusions. *See In re Lawler*, 106 B.R. at 952, *citing Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1210 (7th Cir.), *cert. denied*, 469 U.S. 982, 105 S.Ct. 386, 83 L.Ed.2d 321 (1984).

III. Discussion.

The issue before the Court concerns the interplay of two sections of the Bankruptcy Code. Section 1322(b)(2) of the Bankruptcy Code provides that

> a Plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtors' principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

Section 506 of the Bankruptcy Code provides that

> an allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under Section 553 of this rule, is a secured claim to the extent of the value of such creditor's interest in the estate.

The issue before the Court is whether the Nobelmans may bifurcate a claim secured only by a lien on their principal residence pursuant to section 506 and then modify the unsecured claim without violating section 1322(b)(2).

The Nobelmans rely heavily on the fact that three Courts of Appeals have addressed this issue and concluded that the type of bifurcation provided in the Nobelmans' Plan is not barred by section 1322(b)(2). For their part, appellees rely on a series of bankruptcy cases from several districts barring the sort of bifurcation contemplated by the Plan. The Court turns first to the cases cited by the Nobelmans.

The Ninth Circuit decided the seminal case that supports the Nobelmans' Plan. In *In re Hougland*, the Ninth Circuit stated that the plain meaning of the terms of the statutes at issue showed that "nothing in section 1322 affects the determination under section 506(a) that an undersecured claim can be divided into a secured portion and an unsecured portion." *Hougland v. Lomas & Nettleton Co. (In re Hougland)*, 886 F.2d 1182, 1183 (9th Cir.1989) [hereinafter *In re Hougland*].

The *Hougland* court started by examining section 506, stating that "it is clear that section 506(a) applies to Chapter 13 proceedings" pursuant to section 103(a), and therefore there is "no reason to believe that the phrases 'secured claim' and 'unsecured claim' in section 1322(b)(2) have any meaning other than those given to them by section 506(a)." *Id.* Accordingly, an undersecured claim has a "secured claim" component and an "unsecured claim" component. *See id.* at 1183-84.

The court then turned to the "other than" clause of section 1322.

> That clause follows the secured claim portion of the sentence and precedes the unsecured claim portion. Certainly it refers to what preceded it, and indicates that a secured residential real estate claim will have special protection. Indeed, if the referent of the 'other than' clause is not the secured claim language that precedes it, what could the referent be? It would be most unusual if it were the unsecured claim language or the whole sentence. That strongly indicates that only the 'secured claim' portion is protected.

Id. at 1184. On the basis of this statutory construction, the *Hougland* court dismissed those courts that found that the "other than" clause refers to both the secured and unsecured portions of the undersecured claim as "beg[ging] the question". *Id.*

In *Wilson v. Commonwealth Mortgage*, the Third Circuit adopted the reasoning and ruling of the Ninth Circuit's *Hougland* decision, and held that "section 1322(b)(2) does not preclude the modification of any 'unsecured' portion of an undersecured claim." *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 127 (3rd Cir.1990).

> The statutory construction which some bankruptcy courts have used to support their position that the entire "claim," consisting of both the secured and the unsecured portion of the claim, cannot be modified has been roundly criticized by the Ninth Circuit in *Hougland*. We agree with the Ninth Circuit's view that because the "other than" phrase is best read to refer to secured claims, the "other than" phrase should

> be read to limit modification only of that portion of the claim that is secured.

Id. (citations omitted).

Most recently, the Tenth Circuit Court of Appeals considered this issue in *In re Hart*, and "join[ed] the Third and Ninth Circuits in holding that an undersecured mortgage is, for the purposes of the bankruptcy code, two *claims*, and that only the secured *claim* is protected by section 1322(b)(2)." *Eastland Mortgage Co. v. Hart (In re Hart)*, 923 F.2d 1410, 1415 (10th Cir.1991) [hereinafter *In re Hart*]. Furthermore, the court contended that "while bifurcation, in the literal sense, may be a modification of the *mortgage* represented in the secured and unsecured claims, bifurcation is not, of itself, a 'modification' of the secured claim made impermissible by section 1322(b)(2). Indeed, the act of bifurcation recognizes, but does not affect, the secured claim." *Id.* Accordingly, while recognizing contrary decisions by bankruptcy courts in the Fifth, Eight, Tenth,[1] and Eleventh Circuits, *see id.* at 1414,

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[1] The bankruptcy courts in the Tenth Circuit were split on the issue. *Compare Brouse v. CSB Mortgage Corp. (In re Brouse)*, 110 B.R. 539, 543-44 (Bankr.D.Colo.1990) ("Allowing a debtor to use Section 506(d) to avoid the lien on the unsecured portion of the debtor's principal residence does not negate the Section 1322(b)(2) prohibition of modifying the security interest in real property that is the debtor's principal residence."); *In re Ross*, 107 B.R. 759, 762 (Bankr.W.D.Okla.1989) (finding that the court had previously "erred in holding that § 1322(b)(2) prohibited a determination under § 506(a) as to the extent to which a claim is secured and unsecured"); *and In re Simmons*, 78 B.R. 300, 303 (Bankr.D.Kan.1987) (holding that § 1322(b)(2) does not prohibit bifurcation of an undersecured claim into secured and unsecured claims and that "[t]he cases that hold otherwise

the Tenth Circuit found that "nothing in the plain language of section 1322(b)(2) . . . instructs us to go beyond the Code's statutory definition of the term 'secured claims' to protect the unsecured portion of an undersecured home mortgage." *Id.* at 1415.

In contrast to the Third, Ninth, and Tenth Circuits, numerous bankruptcy courts have found that section 1322(b)(2) prohibit the type of bifurcation contemplated by the Nobelmans' Plan. In *In re Sauber*, the bankruptcy court for the District of Minnesota squarely confronted the Third Circuit's analysis in *Hougland*.

> The Ninth Circuit, in *Hougland*, takes an overly technocratic approach in both analyzing the language of § 1322(b)(2) and (b)(5), and in relating § 506(a) to it. Although ostensibly undertaken in search of the plain meaning of these statutes, that meaning, and the proper setting of the statutes in the context of the overall scheme of the Code, is as clearly missed as the proverbial forest might be missed in examining the trees.

In re Sauber, 115 B.R. 197, 199 (Bankr.D.Minn.1990).

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blindly focus on the ['other than'] clause of § 1322(b)(2)") *with First Interstate Bank of Oklahoma, N.A. v. Woodall (In re Woodall)*, 123 B.R. 95, 98 (Bankr.W.D.Okla.1990) [hereinafter *In re Woodall*] (stating that "using § 506(a) to bifurcate would make the intent of § 1322(b)(2) a nullity, and the Court believes that Congress enacted § 1322(b)(2) for a purpose") *and In re Christiansen*, 121 B.R. 63, 64 (Bankr.D.Colo.1990) (relying on the reasoning of *In re Sauber*, 115 B.R. 197 (Bankr.D.Minn.1990) in holding that § 1322 bars bifurcation of claims secured only by the debtor's residence).

The *Sauber* court argued that "what the *Hougland* court did not seem to appreciate, is that we are dealing with general and specific concepts that are intended to apply to, and govern, the rights of debtors and their creditors in different situations, and with different applications, depending on the particular Code purposes to be served." *Id.* In *In re Sauber,* the court found it plain that Congress provided certain home mortgagees with protection against modification of their rights which might otherwise result from the application of section 506 in Chapter 13 cases. The court found that "[t]he clearly focused concern [of section 1322(b)(2)] is with the rights of *holders* of residential real estate mortgages" and that *Hougland* judicially removed most of that statute by its use of section 506(a) definitions.

The Court finds the analysis presented by the Ninth Circuit in *Hougland* to be strained and unconvincing. To begin with, the *Hougland* court simply assumed that because section 506(a) may be applied to Chapter 13 proceedings pursuant to section 103(a), every undersecured claim in a Chapter 13 proceeding is automatically transformed into a secured and unsecured claim. This assumption is the foundation upon which the entire *Hougland* decision rests, and it is flawed for at least two reasons.

First, under the Third Circuit's analysis the general provision of section 506 controls the more specific provisions of section 1322(b)(2), whereas "[t]he specific provisions found in Chapter 13 *must* be accepted as controlling over the general provisions of Chapters 1, 3, and 5 which are applicable pursuant to § 103(a)." *In re Schum,* 112 B.R. 159, 161 (Bankr.N.D.Tex.1990) (emphasis added). "This

Court accepts the tenet of statutory construction that, regardless of the inclusiveness of the general language of a statute, it does not apply or prevail over matters specifically dealt with in another part of the same enactment." *In re Chavez,* 117 B.R. 733, 734 (Bankr.S.D.Fla.1990) (construing sections 1322(b)(2) and 506(a) and (d)); *see Boullion v. Sapp (In re Boullion),* 123 B.R. 549, 550 (Bankr.W.D.Tex.1990) [hereinafter *In re Boullion*]; *In re Russell,* 93 B.R. 703, 705 (Bankr.D.N.D.1988); *In re Hynson,* 66 B.R. 246, 249-50 (Bankr.D.N.J.1986). To find that section 1322(b)(2) controls over section 506(a), the Court must find that the two sections are in conflict. *See Aeron Marine Shipping Co. v. United States,* 695 F.2d 567, 576 (D.C.Cir.1982). It is clear that a limited conflict exists, in that section 506 can be used to undermine the protection afforded by section 1322(b)(2) under the very narrow circumstances defined by that statute.[2] Because this limited conflict between the statutes exists, the bifurcation theory advanced by the Third, Ninth, and Tenth Circuits is not supported by the language of the section 1322(b)(2).

Second, the *Hougland* court's analysis requires "that § 1322(b)(2) applies only after the secured debt has been reduced to the fair market value of the property. In other words, § 1322(b)(2) 'kicks in' only to prevent any further modification of this secured claim. The problem with this

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[2] The *Hougland* court contended that sections 506(a) and 1322(b)(2) are not in conflict. *See In re Hougland,* 886 F.2d at 1184. The Court finds, however, that the plain terms of the two sections reveal an inescapable, although limited, conflict.

approach is that it renders § 1322(b)(2) essentially meaningless." *In re Hart*, 923 F.2d 1410, 1417 (10th Cir.1991) (Brorby, J., dissenting). It is a basic tenet of statutory construction that a statute should be interpreted so as not to render a part of it inoperative or superfluous. *See Rosado v. Wyman*, 397 U.S. 397, 90 S.Ct. 1207, 25 L.Ed.2d 442 (1970); *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir.1972); *Ensearch International Exploration, Inc. v. Attock Oil Co.*, 656 F.Supp. 1162, 1165 (N.D.Tex.1987). The bankruptcy court in *In re Schum* stressed this point in prohibiting a modification of the secured status of a claimant whose claim is secured only by the principal residence of the debtor. *See In re Schum*, 112 B.R. at 162; *see also In re Woodall*, 123 B.R. at 98 (stating that "using § 506(a) to bifurcate would make the intent of § 1322(b)(2) a nullity, and the Court believes that Congress enacted § 1322(b)(2) for a purpose").

Although the *Hougland* court purported to discern the plain meaning of section 1322(b)(2), it ignored the congressionally dictated definition of the term "claim", which is a "right to payment", whether secured or not. 11 U.S.C. § 101(5)[3]; *see In re Mitchell*, 125 B.R. 5, 6 (Bankr.D.N.H.1990) (quoting *In re Moran*, 121 B.R. 879, 882 (Bankr.E.D.Okla.1990) in finding that " 'in order to afford § 1322(b)(2) any relevant meaning, we must find

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[3] Although several courts refer to 11 U.S.C. § 101(4) as providing the Bankruptcy Code's definition of "claim," recent amendment of section 101 added a new section 101(3) (defining "federal depository institutions regulatory agency"), which resulted in the redesignation of section 101(4) as section 101(5). *See* 11 U.S.C.A. § 101, Historical and Statutory Notes (1979 & Supp.1991).

that the "claim" referred to in this section applies to the entire claim' " as defined by section 101(4) of the Bankruptcy Code and therefore that " 'this would include both the secured and unsecured portion of the creditor's claim.' "); *Bayless v. Crabtree ex rel. Adams*, 108 B.R. 299, 305 (Bankr.W.D.Okla.1989) (holding that "claim" under bankruptcy laws includes virtually all legal or equitable rights to payment and must be broadly construed). As the court in *In re Sauber* correctly observed, the "clearly focused concern [of section 1322(b)(2)] is with the rights of *holders* of residential real estate mortgages." *In re Sauber*, 115 B.R. at 199. Rather than following the *Hougland* court and reading the general provisions of section 506 into the more specific provisions of section 1322 in order to change the meaning of the word "claim," the courts finding that section 1322(b)(2) prohibits the type of bifurcation sought by the Nobelmans "believe[ ] that the statute means what it says. Congress meant to establish a special protected class of creditors in a Chapter 13 case under § 1322(b)(2). To read the statute other than literally, as many courts have done, is to permit inroads into a protection afforded a class of creditors by Congress." *In re Boullion*, 123 B.R. at 551.

Although the *Hougland* court did not look to legislative history to determine the proper interplay between section 506(a) and 1322(b)(2), the Third and Tenth Circuits did examine the historical context of those provisions. *See In re Hart*, 923 F.2d at 1412-13; *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d at 127-28. Put briefly, the legislative history shows that section 1322(b)(2) was a compromise between sharply contrasting proposals. So far as the precise issue presently before

the Court is concerned, the intent of Congress in passing section 1322(b)(2) is not clearly expressed in the legislative history, although there is no question that Congress intended to accord home mortgagees preferred treatment under the law. *See Id.* at 128 (finding that "it is clear that the anti-modification provision" was "inserted on behalf of the home mortgage industry"); *In re Hougland*, 886 F.2d at 1185 (stating that "Congress intended to benefit residential real estate lenders"). The Fifth Circuit's analysis of section 1322(b)(2)'s legislative history does indicate, however, that section 1322(b)(2) was intended to prohibit the type of bifurcation sought by the Nobelmans.

In *Grubbs v. Houston First American Savings Association*, the Fifth Circuit analyzed the legislative history of section 1322 at length and found that the curing of arrearages in Chapter 13 plans was not a "modification" under the terms of the statute and therefore was not prohibited by sections 1322(b)(2) and (b)(5).

> The final amendments to H.R. 8200 and S.B. 2266 (the latter being the Senate's amended version of the House bill), were accomplished by a series of agreed-upon floor amendments in both houses, by which differences between the two versions were reconciled and compromised. With regard to § 1322(b)(2), the Senate receded from its position that no "modification" was to be permitted of *any* mortgage secured by real estate; it instead agreed to a provision that modification was to be barred *only* as to a claim "secured only by a security interest in real property *that is the debtor's principal residence.*" This limited bar was apparently in response to perceptions, or to suggestions advanced in the legislative hearings that homemortgagor lenders,

> performing a valuable social service through their loans, needed special protection against modification thereof (*i.e.*, reducing installment payments, secured valuations, etc.).

Grubbs v. Houston First American Savings Ass'n, 730 F.2d 236, 246 (5th Cir.1984) (citation omitted).

In addition, "[i]t must also be remembered that the prior Bankruptcy Act did not allow Chapter 13 debtors to modify secured claims." *In re Mitchell*, 125 B.R. at 8. Because the legislative history of section 1322(b)(2) does not indicate any congressional intent to alter the status quo, "[t]his suggests Congress did not want to effect a change with respect to home mortgages." *Id.*

> I conclude that § 1322(b)(2) continued the prohibition on modifying the rights of holders of claims secured by real estate, but only with respect to real estate that constitutes the debtor's principal residence. If Congress had intended to change the manner in which a claim secured by a debtor's residence would be treated under the Code it would have specifically limited § 1322(b)(2) to claims secured pursuant to § 506. However, as Congress did not explicitly change the treatment of claims secured by a mortgage on a debtor's residence, I conclude that a continuity of treatment of such claims was intended.

In re Kaczmarczyk, 107 B.R. 200, 203 (Bankr.D.Neb.1989).

Following the interpretation of the intent of Congress in enacting section 1322(b)(2), the Court finds that applying section 506(a) to the secured claim at issue in this case would mean allowing a "modification" prohibited by the statute. "The proposed modification of the debt at issue

would have the effect of treating real property secured by only a lien on the debtor's principal residence in the same manner as any other property secured by a lien. Such treatment would frustrate the legislative intent of § 1322(b)(2)." *In re Schum,* 112 B.R. at 162. Furthermore, "bifurcation of § 1322(b)(2) claims would result in a windfall to debtors who would then repay only the value of their residence, and reap the benefit of their discharged 'unsecured' claim if property values rise." *In re Woodall,* 123 B.R. at 97-98. Such a use of section 506(a) to bifurcate claims into secured and unsecured claims would produce "a result contrary to the Bankruptcy Code's intended 'fresh start.' " *Id.* at 98.

The Court is aware of the conflicting decisions of courts in other jurisdictions. The plain language of section 1322(b)(2) and the Fifth Circuit's analysis in *Grubbs v. Houston First American Savings Association* convince the Court that a modification of the secured status of a claimant whose claim is secured only by the principal residence of the debtors is prohibited under the Bankruptcy Code. "To determine otherwise would be to vitiate any protection that § 1322(b)(2) is obviously intended to provide home mortgage lenders." *In re Moran,* 121 B.R. at 882. Accordingly, the ruling of the bankruptcy court is AFFIRMED.

The Nobelmans also argue that their requested bifurcation is allowed under section 1322(b)(2) because the deed of trust at issue here provides for a security interest in an undivided .67% interest in the common areas of the condominium complex, escrow funds, proceeds of hazard insurance, and rents, in addition to the residence itself. The Court finds this contention to be without merit. *See*

Equity Investment Co. v. Moreland (In re Moreland), 124 B.R. 921, 922 (Bankr.D.Conn.1991) (finding meritless an argument that because a mortgage extended to such things as rents, royalties, stock and fixtures the mortgagee's claim was not secured "only" by realty).

IV. Conclusion.

For the reasons stated above, the Order of the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, entered March 12, 1991 is AFFIRMED.

SO ORDERED.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	CASE NO.
LEONARD and HARRIET NOBELMAN,	§	390-35116-HCA-13
	§	
Debtors	§	
	§	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The present dispute concerns the treatment of a creditor whose claim is secured by a lien on a debtor's principal residence under a Chapter 13 plan of reorganization.

The Court finds that this matter is a core proceeding under 28 U.S.C. § 157(a), (b)(2)(A) & (L). The following constitutes the Court's findings of Fact and Conclusions of Law pursuant to Federal Rule of Bankruptcy Procedure 7052.

FACTS

1. On June 21, 1984, Leonard and Harriet Nobelman (the "Debtors") executed a note in the amount of $68,250.00 payable to American Savings Bank, N.A. ("American"), secured by a purchase money Deed of Trust on the primary residence of the Debtors. Murray Mortgage Company ("Murray") is the duly authorized servicing agent of American.[1]

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[1] Murray filed an objection to confirmation of the Plan in this case. The Court shall refer to claim holder as "Murray."

2. On August 6, 1990, Debtors filed a voluntary petition for relief under Chapter 13 of the United States Bankruptcy Code.

3. On August 14, 1990, Murray filed its proof of claim for $71,265.04 which was later amended as a claim for $71,335.04.

4. Debtors filed their Chapter 13 Plan of Reorganization (the "Plan") on August 31, 1990, which was later modified. The Plan values the residence at $23,500.00 Debtors filed a Motion for Valuation along with the modifications to their Plan.

5. At confirmation, the Debtors offered the testimony of Leonard Nobleman, regarding the value of the property. No controverting evidence of the value was offered by any other parties.

6. The Plan proposes to make direct payments to Murray at the mortgage contract rate only up to scheduled value of the collateral. The balance of Murray's claim ($41,257.66) is treated as a general unsecured claim under the Plan, payable pari passu.

7. The unsecured creditors receive nothing under the Chapter 13 Plan.

8. The Debtors propose to cure the prepetition arrearage owed to Murray through their Plan.

9. Both Murray and the Standing Chapter 13 Trustee objected to the confirmation of the Plan on the grounds that, *inter alia*, the Plan purports to alter the lien holders rights prohibited by 11 U.S.C. § 1322(b)(2)(1989 Supp.).

CONCLUSIONS OF LAW

1. It appears to this Court that the secured creditor has no interest in rents or proceeds generated by the collateral inasmuch as no income is currently generated from the Debtors residence. Hence, the argument that Murray is secured by rents and outside the scope of § 1322(b)(2) is inapplicable to the present dispute.

2. A debtor's Chapter 13 plan of reorganization may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtors' principal residence . . . " § 1322(b)(2).

3. As this Court has previously ruled, § 1322(b)(2) of the United States Bankruptcy Code precludes a Chapter 13 debtor from modifying the rights of a creditor whose claim is secured only by an interest in the debtor's principal residence. *In re Schum*, 112 B.R. 159 (Bkrtcy. N.D. Tex. 1990) (*citing, In re Kaczmarczyk*, 107 B.R. 200 (Bkrtcy. Neb. 1989)).

4. The Plan impermissibly proposes to modify Murray's rights which are secured by the Debtor's residence. Specifically, the Plan seeks to bifurcate Murray's claim into secured and unsecured claims in violation of § 1322(b)(2). *See In re Schum, Id.*

Accordingly, confirmation of the Plan is **DENIED**. Counsel for the Standing Chapter 13 Trustee is requested to prepare an appropriate order, and submit same to the Court with copy to opposing counsel.

Signed this 13th day of February 1991.

/s/ Harold C. Abramson
Harold C. Abramson
United States Bankruptcy
Judge

Supreme Court, U.S.
FILED
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(2)

No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

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QUESTION PRESENTED FOR REVIEW

Does 11 U.S.C. § 1322(b)(2) (1988) prohibit a debtor from bifurcating a secured claim, secured only by a security interest in real property that is the debtor's principal residence, into a secured portion equal to the value of the real property and an unsecured portion for the remainder of the indebtedness?

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No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Respondent, AMERICAN SAVINGS BANK, F.S.B., by and through its undersigned counsel, respectfully requests that this Court deny the Petition for Writ of Certiorari submitted by Petitioners, LEONARD NOBELMAN AND HARRIET NOBELMAN.

STATEMENT

There are errors and omissions in Petitioners' list of all parties to the proceedings. Petitioners' listing on page ii of Tim N. Truman as the Standing Chapter 13 Trustee for the Northern District of Texas is incorrect in that

Molly W. Bartholow has succeeded Mr. Truman as trustee in this case. Likewise, Petitioners' listing on page ii of Murray Mortgage Company is also incorrect because STM Mortgage Company has succeeded Murray Mortgage Company as servicing agent for Respondent.

There is an error in Petitioners' statement on jurisdiction on page 1 which incorrectly invokes jursdiction under 28 U.S.C. § 1254(2) (1988). Petitioners seek review by Writ of Certiorari under 28 U.S.C. § 1254(1) (1988).

Petitioners incorrectly cite on page 1 Article II, Section 8 of the Constitution of the United States as a constitutional provision involved in this case. Article I, Section 8 of the Constitution of the United States addresses the subject of bankruptcies. U.S. CONST. art. I, § 8, cl. 4.

Petitioners' argument contains a misstatement of fact. Petitioners' assertion on page 3 that the Fifth Circuit's opinion in this case did not mention the Third Circuit's decision in *Sapos v. Provident Institution of Savings in Town of Boston*, 967 F.2d 918 (3rd Cir. 1992), is incorrect because the Fifth Circuit's opinion discusses *Sapos. Matter of Nobleman*, 968 F.2d 483, 486 n.6 (5th Cir. 1992).

REASONS FOR DENYING THE WRIT OF CERTIORARI

1. THE FIFTH CIRCUIT'S DECISION IS CONSISTENT WITH THIS COURT'S DECISION IN *Dewsnup v. Timm*, 502 U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). THE FIFTH CIRCUIT'S DECISION IN *Grubbs v. Houston First American Savings Association*, 730 F.2d 236 (5th Cir. 1984) (en banc), AND BANKRUPTCY COURT DECISIONS.

The narrow issue of whether a debtor may, under 11 U.S.C. § 506(a) (1988), "strip down" a creditor's lien on real property to the value of the collateral when that value is less than the amount of the claim secured by the lien has been addressed by this Court in *Dewsnup v. Timm*, 502 U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). In *Dewsnup*, this Court held that "§ 506(d) does not allow [a debtor] to 'strip down' [a creditor's] lien, [where a creditor's] claim is secured by a lien and has been fully allowed pursuant to § 502." *Dewsnup*, 502 U.S. at ___, 112 S.Ct. at 778, 116 L.Ed.2d at 911.

Indeed, this Court concluded in *Dewsnup* that "to grant a debtor the broad new remedy against allowed secured claims to the extent that they become 'unsecured' for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles." *Dewsnup*, 502 U.S. at ___, 112 S.Ct. at 779, 116 L.Ed.2d at 913. This Court reasoned that: "[T]he creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and mortgagee." *Dewsnup*, 502 U.S. at ___, 112 S.Ct. at 778, 116 L.Ed.2d at 911.

Consistent with this Court's holding in *Dewsnup*, the Fifth Circuit properly refused to permit Petitioners to "strip down" Respondent's secured claim. The Fifth Circuit's holding is also consistent with its prior decision in *Grubbs v. Houston First American Savings Association*, 730 F.2d 236 (5th Cir. 1984) (en banc). Although the Fifth Circuit did not specifically address the interplay between 11 U.S.C. § 506(a) (1988) and 11 U.S.C. § 1322(b)(2) (1988), the Court of Appeals did observe that the legislative intent of § 1322(b)(2) was not to permit any modifications of a claim secured by the debtor's principal residence. *Grubbs*, 730 F.2d at 246.

Finally, the Fifth Circuit's opinion is consistent with Bankruptcy Court decisions which have held that a debtor may not, under 11 U.S.C. § 506(a) (1988), "strip down" a creditor's lien on real property to the value of the collateral when that value is less than the amount of the claim secured by the lien. *Nobleman*, 968 F.2d at 486-87 (and cases cited therein).

CONCLUSION

For the above and foregoing reasons, Petitioners' Writ of Certiorari should be denied.

Respectfully submitted,

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FOR THE FIFTH CIRCUIT

BRIEF FOR AMICI CURIAE FEDERAL HOME LOAN MORTGAGE CORPORATION AND MORTGAGE BANKERS ASSOCIATION OF AMERICA IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Does Section 1322(b)(2) of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"), which provides special protection for residential mortgage lenders in cases under Chapter 13 of the Bankruptcy Code, prohibit a Chapter 13 debtor from modifying the rights of a creditor holding a claim secured only by a mortgage on debtor's principal residence by "cramming down" that creditor's claim to the value of the

property under Section 506(a) of the Bankruptcy Code, and then discharging the balance of the claim with unsecured debts under a Chapter 13 plan?

Amici Curiae Federal Home Loan Mortgage Corporation ("Freddie Mac") and Mortgage Bankers Association of America ("MBAA") agree with Petitioners that the Court should grant the petition for a writ of certiorari in this case in order to resolve this important issue.

STATEMENT OF INTEREST OF AMICI CURIAE

Freddie Mac is a corporate instrumentality of the United States, chartered by Congress as part of the Emergency Home Finance Act of 1970, Pub. L. No. 91-351, tit. III, 84 Stat. 450 (codified as amended at 12 U.S.C. §§ 1451-59). Its statutory mission is to foster and promote a secondary market for the purchase and sale of mortgages on residential property.

Freddie Mac acts in the secondary mortgage market to increase the liquidity of mortgage investments and thereby make more capital available for home financing. Banks, savings associations and other lenders originate loans in the primary mortgage market, and then sell those loans in the secondary mortgage market to Freddie Mac. Freddie Mac, in turn, resells the mortgages to investors in the form of mortgage pass-through securities which represent interests in groups of mortgages. With the funds received from the resale of the mortgages, Freddie Mac purchases more mortgages from originating lenders who in turn make those funds available to home purchasers. The secondary mortgage market thus greatly increases the supply, and reduces the cost, of home mortgage credit to America's homeowners.

The smooth functioning of this market depends upon a predictable flow of principal and interest from home mortgages. Where cram-down is permitted, and borrowers are allowed unilaterally to reduce the balance of their mortgage loans, this predictability is undermined. Freddie Mac and other entities operating in the secondary mortgage market therefore have a strong interest in the resolution of the question presented for review in this case.

MBAA is a non-profit corporation headquartered in Washington, D.C. and existing under the General Not For Profit Corporation Act of Illinois. MBAA is the primary national trade association devoted exclusively to the field of mortgage and real estate financing. Mortgage banking firms, which comprise the largest part of MBAA's total membership of 2600 corporations, engage directly in originating, financing, selling and servicing mortgages. "Origination" is the bringing of the mortgage into existence as the result of negotiating, arranging, and funding the loan to home buyers. "Servicing" is the collection of payments on existing loans, monitoring the payment of real property taxes and other charges to protect the priority of the mortgage lien, and facilitating the realization of the security in the event of nonpayment. In 1991, mortgage bankers originated more than $298 billion in single-family mortgages and serviced in excess of $1 trillion in single-family mortgages. Especially significant in the context of this case, MBAA members originate and service 65 to 80 percent of the home purchase mortgages in programs that Congress has designed to encourage home ownership by facilitating low down payment loans to home buyers.

SUMMARY OF ARGUMENT

The Court should grant the petition for a writ of certiorari. The question of whether the special protection afforded to residential mortgage lenders under Section 1322(b)(2) of the Bankruptcy Code protects those lenders from "cram-down"– that is, forced reduction of the amount of the loan in question to the value of the collateral securing it – is one of national scope and considerable importance, both to institutions such as MBAA and Freddie Mac, which operate in the primary and secondary mortgage markets, and to American homeowners, whose ability to obtain mortgage credit will be affected if "cram-down" is permitted. In holding that "cram-down" is not permissible under Section 1322(b)(2) of the Bankruptcy Code, the Fifth Circuit Court of Appeals is in direct conflict with four other circuit courts of appeals on the question presented. Clear resolution of the permissibility, or lack thereof, of cram-down is necessary to avoid complete uncertainty in the primary and secondary

mortgage markets. Further, different rules in different circuits would result in certain loans being available to potential homebuyers but not to others based solely upon the state in which they happen to reside.

ARGUMENT FOR GRANTING WRIT OF CERTIORARI

1. The Circuit Courts of Appeals Have Rendered Conflicting Decisions Regarding the Ability of a Chapter 13 Debtor to Cram-Down a Residential Mortgagee's Claim

The Court of Appeals for the Fifth Circuit has held that Section 1322(b)(2) of the Bankruptcy Code precludes Chapter 13 debtors from "cramming down" the secured claim of a mortgagee holding a lien on the debtor's principal residence to the value of the property. *Nobelman v. American Savings Bank*, 968 F.2d 483 (5th Cir. 1992). Four other circuit courts addressing this question have issued decisions that directly conflict with the Fifth Circuit's decision. Those courts have permitted "cram-down" of a residential mortgage holder's claim notwithstanding the special protection afforded to such a creditor by Section 1322(b)(2) of the Bankruptcy Code. *See Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176 (2d Cir. 1992); *In re Hart*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990); *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989).

Three of the decisions allowing cram-down by Chapter 13 debtors were decided prior to the decision in *Dewsnup v. Timm* ___ U.S. ___, 112 S. Ct. 773 (1992), in which this Court held that a Chapter 7 debtor may not "cram-down" a creditor's lien on real property to the value of the collateral when that value is less than the amount of the claim secured by the lien. Although the fourth case, *Bellamy*, was decided after *Dewsnup*, all briefs were submitted and oral argument completed before the *Dewsnup* decision was rendered. Thus, Freddie Mac and amici curiae (which included MBAA) in that case did not have the opportunity to explain the full impact of the *Dewsnup* decision

to the Second Circuit.* Indeed, at least one court, in addition to the Fifth Circuit, has held that the decisions allowing cram-down of a residential mortgage holder's claim in Chapter 13 cases had been "weakened, if not demolished, by *Dewsnup*". *In re Strober*, 136 B.R. 614, 618 (Bankr. E.D.N.Y. 1992).

In addition, the decisions of the Third, Ninth and Tenth Circuits permitting cram-down were rendered without the benefit of briefing by Freddie Mac or MBAA, or any similarly situated *amici curiae*. As a result, in making their decisions those courts did not have the opportunity to consider such matters as the negative impact that a decision allowing "cram-down" of residential mortgage debts could have on the primary and secondary mortgage markets, or the impact of such a decision on the Congressional policy favoring investment in home ownership that was the basis for Section 1322(b)(2) of the Bankruptcy Code.

2. The Resolution of This Issue Will Have an Important Impact on the Secondary Mortgage Market and on Availability of Credit to Potential Homebuyers

It is important that this Court grant certiorari in this matter because resolution of the question of whether Chapter 13 debtors may "cram-down" their home mortgage lender could have a significant impact on the secondary mortgage market and on the availability of credit for home purchases generally.

The secondary mortgage market, in which Freddie Mac operates, may be impaired if Chapter 13 debtors are permitted to cram-down the claims of residential mortgagees. In the secondary market, banks, savings associations and other lenders sell mortgages to Freddie Mac and other institutions which in turn, resell the mortgages in the form of mortgage-backed securities. This process, fostered by substantial Congressional

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* Freddie Mac petitioned the Second Circuit for rehearing and rehearing *en banc* based, in part, on the *Dewsnup* decision. The Second Circuit, however, denied the request for rehearing.

legislation, has greatly increased the availability of home mortgage credit in the United States.

However, the secondary mortgage market only can offer such advantages to the individual home buyer if a predictable flow of principal and interest from mortgages can be maintained. If cram-down is permitted, and borrowers are allowed unilaterally to reduce the balance of their mortgage loans, this predictability is undermined, and the ability of entities operating in the secondary mortgage market to continue to supply low-cost and plentiful credit to America's homeowners may be adversely affected.

The resolution of this issue is all the more important because of the skyrocketing numbers of personal bankruptcy filings. According to a recent article in the Washington Post, personal bankruptcies have reached record levels over the past seven years, more than tripling since 1984. In 1991, 872,000 people filed for personal bankruptcy, 150,000 more than in 1990, which is by far the largest increase in a single year. *See* Carolyn Hughes Crowley, *You; Bankrupt; No Way Out; Many Americans Can't Even Afford to File*, Washington Post, May 5, 1992 at B5. Indeed, a record 252,733 personal bankruptcies were filed during the first quarter of 1992. *See Short Cuts*, Newsday, October 6, 1992, Business Section at p. 31.

While a portion of those personal bankruptcies are Chapter 7 cases, Chapter 13 is becoming increasingly popular and the number of these cases have similarly exploded. According to statistics compiled by the Administrative Office of the United States Courts, 244,192 Chapter 13 cases were filed for the year ended June 30, 1991. *Report on the Judicial Conference, Report of the Administrative Office of U.S. Courts* 1991 at p297. For the following year, ended June 30, 1992, 267,121 Chapter 13 cases were commenced – an increase of over 9%. *Statistical Tables for Twelve Month Period Ended June 1992.*

With the continually increasing rise in the number of Chapter 13 filings, the need for a clear resolution of the availability of cram-down is all the more urgent. Freddie Mac and MBAA therefore respectfully submit that the petition for writ of certiorari in this case should be granted.

CONCLUSION

The petition for writ of certiorari should be granted.

November 11, 1992

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INTEREST OF THE AMICUS

The Amicus, Harold J. Barkley, Jr., is the Standing Chapter 13 Trustee for the Southern District of Mississippi, Jackson Division. This Trustee respectfully submits this Brief Amicus Curiae in support of the Petitioner.

In a bankruptcy situation, the value of a homestead is usually closely related to the amount of the debt securing the first deed of trust on the homestead. In practice or reality, in addition to the first deed of trust, it is becoming increasingly common in states where permitted by law for a lender (loan company) or a consumer creditor (short term finance companies) to advance money to a debtor in an amount that exceeds the value of the homestead and taking a second deed of trust on the homestead for this

additional sum of money. Furthermore, it is not uncommon for a third lender or consumer creditor to advance money in an amount that further exceeds the value of the homestead in return for a third deed of trust on the homestead. The purpose of these additional loans are many times wholly unrelated to either the purchase of the home or home improvement.

The monthly payment secured by the first deed of trust is usually small enough that the debtor can maintain that payment; however, after adding the monthly payments on the debts secured by the second and third deed of trust, the debt becomes burdensome or impossible for the debtor to pay. The *Nobelman* decision has effectively prohibited lien stripping in the Fifth Circuit. After *Nobelman* an undersecured creditor who holds a valueless lien may receive a greater distribution in a Chapter 13 plan than general unsecured creditors and certainly more than that same undersecured creditor would receive in a foreclosure situation. It is inequitable that a debtor should lose his major asset, his home, because of the inability to maintain payments on a loan not supported by value.

SUMMARY OF ARGUMENT

Presently in Mississippi there is one reported case on the issue before this Court[1] – may a debtor's Chapter 13 plan employ 11 U.S.C. 506 to bifurcate a mortgage lien claim on debtor's principal residence into an allowed

[1] *Franklin v. Union Mortgage Co. (In re Franklin)*, 126 B.R. 702 (Bankr. N.D. Miss. 1991).

secured and an allowed unsecured portion of the claim? The *Nobelman* decision has overruled the holding of *Franklin*.

By allowing the debtors to bifurcate the mortgage lien claim pursuant to 11 U.S.C. 506 and then prohibiting a modification of the secured claim as contemplated by 11 U.S.C. 1322(b)(2), the Bankruptcy Code is applied systematically and coherently rather than a finding of conflict of Code sections or a disregard of certain sections of the Code. To prohibit bifurcation of a claim is to find a conflict between 11 U.S.C. 506 and 11 U.S.C. 1322(b)(2), and 11 U.S.C. 103(a) is simply ignored if bifurcation is not allowed.

ARGUMENT

Since 1979, numerous lines of cases have evolved concerning the status of home mortgages covered under Section 1322(b)(2). The first line of cases states that while Section 506 applies in cases under Chapters 7, 11, and 13 of the Bankruptcy Code, Section 1322 applies only in Chapter 13 cases and that regardless of the inclusiveness of the general language of the statute, Section 506 will not apply over matters specifically dealt with in another part of the Code. *In re Hynson*, 66 B.R. 246, 249 (Bankr. D.N.J. 1986).

Secondly, a theory was recognized that if any collateral other than the debtor's principal residence secured the loan, then the claim could be modified. *In re Stiles*, 74 B.R. 708 (Bankr. N.D. Ala. 1981) (debts secured by security interest in debtor's credit life policy as well as

debtor's residence could be modified in Chapter 13 plan); *In re Simpkins*, 16 B.R. 956 (Bankr. E.D. Tenn. 1982) (second mortgage note secured by debtor's principal residence and security interest in motor home could be modified); *United Companies Financial Corporation v. Brantley*, 6 B.R. 178 (Bankr. N.D. Fla. 1980) (modification of mortgage note allowed where debt was secured by an assignment of life insurance policy as well as by the mortgages). The courts, in reaching the holdings in the above cited cases, relied on the legislative history and intent of Section 1322(b)(2), which they contended was designed to provide stability in the residential long-term home financing industry and market. There is no question that Congress intended some protection to institutional lenders engaged only in providing long-term home mortgage financing; however, the question is – how much protection did Congress envision? Four Circuit Courts of Appeal have limited the protection to the secured portion of the claim. *See Bellamy v. Federal Home Loan Mortgage Co. (In re Bellamy)*, 962 F.2d 176 (2d Cir. 1992); *Sapos v. Provident Inst. of Sav. In Town of Boston*, 967 F.2d 918 (3d Cir. 1992); *Eastland Mortgage Co. v. Hart (In re Hart)*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Bank*, 895 F.2d 123 (3d Cir. 1990); *Hougland v. The Lomas & Nettleton Co. (In re Hougland)*, 886 F.2d 1186 (9th Cir. 1989). More recently, the Ninth Circuit reaffirmed the *Hougland* decision in *Lomas Mortgage v. Wiese (In re Wiese)*, Nos. 91-36082, 91-36173, 1992 WL 354917 (9th Cir. Dec. 4, 1992).

The third line of cases allowed modification of a secured mortgage secured only by the debtor's principal residence by first looking to Section 506 to determine

whether a claim was secured and if the claim was not secured under Section 506, then the creditor was not entitled to the protection of Section 1322(b)(2). The court opined that a review of Section 506 indicated a desire on the part of Congress to make certain that creditors claiming to be secured, who, in fact, are not secured, should not enjoy a priority payment status over other unsecured creditors. *In re Bruce*, 40 B.R. 884, 887 (Bankr. W.D. Va. 1984). *See also In re Morphis*, 30 B.R. 589 (Bankr. N.D. Ala. 1983) and *In re Neal*, 10 B.R. 535 (Bankr. S.D. Ohio 1981).

The fourth theory regarding second mortgages specifically says that short-term consumer loan type debts secured by a security interest in the principal residence are not entitled to the protection of Section 1322(b)(2), notwithstanding the fact that the value of the real estate may be high enough to make the debt fully secured. *In re Shaffer*, 84 B.R. 63, 67 (Bankr. W.D. Va. 1988). This theory is not an issue here, but merely offered for the proposition that Section 1322(b)(2) is not inviolate. Of concern here is the rationale of the first and third line of cases regarding the applicability of the statutes. In the first line of cases there is a conflict between Sections 506 and 1322; the third line of cases suggests that Section 506 is a definitional statute and must be used before applying Section 1322(b)(2) to determine the secured portion of the claim.

Clearly there is precedent for this Court to bifurcate the claim of American Savings Bank even though the indebtedness is secured only by the Debtors' homestead. Section 506(a) is a definitional statute, and, further, pursuant to Section 103(a), Chapter 5 applies to Chapter 13 cases. 11 U.S.C. 103(a).

This Court is urged to consider the fresh start aspect mentioned in the *Folendore* case. *Folendore v. U. S. Small Business Admin.* (*Matter of Folendore*), 862 F.2d 1537 (11th Cir. 1989). While realizing a Chapter 7 debtor must redeem "stripped down" claims, certainly the Chapter 13 debtor deserves the same fresh start and should be allowed to void a lien to the extent it is unsecured. The secured claim is not being modified nor crammed down. The terms of the contract remain unaltered and the creditor will receive the same amount as in a foreclosure under state law. Chapter 5 is omnibus, and Section 506 cannot be disregarded in a Chapter 13 case simply because of Section 1322(b)(2). The various sections of the Code are not dichotomous; they should be read together.

While aware of this Court's holding in *In re Dewsnup*, ___ U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), the Court is also urged to follow the rationale of the Second and Third Circuits and limit *Dewsnup* to its particular facts. *In re Bellamy*, 962 F.2d 176 (2d Cir. 1992). *In re Sapos*, 967 F.2d 918 (3d Cir. 1992). Indeed, this Court itself alluded that *Dewsnup* did not apply to all fact situations. 112 S.Ct. at 778. In the only Mississippi Bankruptcy Court decision concerning the issue before this Court, Judge David W. Houston, III found that the "*Dewsnup* rationale results in an unnecessary emasculation of Section 506(d)." *Franklin v. Union Mortgage Co.* (*In re Franklin*), 126 B.R. 702, 710 (Bankr. N.D. Miss. 1991).

Judge Houston succinctly brought the issue of bifurcation in a Chapter 13 case into perspective – "one must hypothetically apply the Chapter 7 *majority* viewpoint, which allows the use of Section 506(d) to avoid undersecured or unsecured liens," to a Chapter 13 scenario.

Franklin at 710. If Chapter 7 debtors may utilize Section 506 to their benefit, then Chapter 13 debtors are penalized by the prohibition of using Section 506. *Id.* The debtors in the *Franklin* case, as well as the Debtors in the case herein, if the Chapter 7 majority viewpoint were applied, could have filed a Chapter 7 and in the *Franklin* case avoided the lien entirely and avoided the lien partially in the case *sub judice*. *Id.* "To say that similar relief should not be available for the debtors in their existing 13 case is illogical." *Id.* (*See also In re Franklin*, 126 B.R. 702, 711-712 (Bankr. N.D. Miss. 1991) for an excellent discussion of how the secured portion of a claim is treated if bifurcation is allowed.)

Further, a determination that Section 506 may be applied in a Chapter 13 case notwithstanding Section 1322(b)(2) does not "undercut the congressional policy of protecting long-term mortgage-backed obligations." *In re Frost*, 96 B.R. 804, 807 (Bankr. S.D. Ohio 1989), *aff'd*, 123 B.R. 254 (S.D. Ohio 1990). The mortgagee has the control regarding the ratio of value to loan amount. Absent unforeseen circumstances, the first mortgage holder is usually fully secured. *Id.* All one has to do to be aware of the recession in this country and the poor economy is glance at the front page of any newspaper on any given day. This writer submits that this unforeseen or unexpected bottoming out of the economy affects debtors and creditors alike. It is an unhappy and frightening situation. But to force a debtor to pay $70,000.00 for a home worth $23,500.00 is not the answer.

Individuals in Texas are afforded a great deal of "homestead" protection by the Texas Constitution[2] and codified by statute.[3] Only a purchase money lien or a lien

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[2] **Homestead; protection from forced sale; mortgages, trust deeds and liens**

Sec.50. The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for the purchase money thereof, or a part of such purchase money, the taxes due thereon, or for work and material used in constructing improvements thereon, and in this last case only when the work and material are contracted for in writing, with the consent of both spouses, in the case of a family homestead, given in the same manner as is required in making a sale and conveyance of the homestead; nor may the owner or claimant of the property claimed as homestead, if married, sell or abandon the homestead without the consent of the other spouse, given in such manner as may be prescribed by law. No mortgage, trust deed, or other lien on the homestead shall ever be valid, except for the purchase money therefor, or improvements made thereon, as hereinbefore provided, whether such mortgage, or trust deed, or other lien, shall have been created by the owner alone, or together with his or her spouse, in case the owner is married. All pretended sales of the homestead involving any condition of defeasance shall be void. This amendment shall become effective upon its adoption. Amended No. 6, 1973.

Tex. Const. art. 16, § 50.

[3] **41.001. Interests in Land Exempt from Seizure**

(a) A homestead and one or more lots used for a place of burial of the dead are exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property.

(b) Encumbrances may be properly fixed on homestead property for:

(1) purchase money;

(2) taxes on the property; or

(3) work and material used in constructing improvements on the property if contracted for in writing before the

for home improvement may encumber a Texas homestead. However, in Mississippi there is no such protection. There is no limit to the number and types of liens that may be secured by the homestead. Certainly it is poor judgment to encumber one's home with such liens, but there has never been a truer statement than "hindsight is 20/20." It is also important to note than many times the debtor does not possess either an equal bargaining position with the lender or a full understanding of the documents which are required to be executed in order to obtain the loan. Additionally, the economic status of the debtor leaves him no other option than to bargain away his most valuable and necessary asset.

For a short time, by virtue of the *Franklin* decision, the debtor in Mississippi was able to bifurcate the claim(s) on his homestead and pay only the secured value, and, if all plan payments were completed, he could avoid the unsecured portion of the liens. This avoidance power gave the debtor the fresh start which is the heart of the Bankruptcy Code. *Folendore* at 1540. Further, rather than the debtor receiving a windfall, Section 506 "permits the debtor to eventually repurchase an equity interest" in the property. *Id.* The *Nobelman* decision has effectively halted lien stripping in Mississippi, leaving the debtors

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material is furnished or the labor is performed and in a manner required for the conveyance of a homestead, with joinder of both spouses if the homestead claimant is married.

(c) the homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale.

Tex. Prop. Code, § 41.001 (1991).

with no relief or remedy available to retain their home encumbered by valueless liens.

Consider a hypothetical debtor in Mississippi whose home is encumbered by three liens – not an unusual fact pattern. With the residence having an uncontroverted value of $25,000.00, the first lien is purchase money and is fully secured with an indebtedness of $20,000.00. The second lien holder has a claim for $15,000.00 and the third a claim of $10,000.00. The debtor cannot use the cram down provision of the Bankruptcy Code, 11 U.S.C. 1322(b)(2), as the liens are secured only by the debtor's homestead. Therefore, the debtor, prior to the *Franklin* case, and now subsequent to *Nobelman*, had or has to maintain three mortgage payments and cure the mortgage payment arrears on three mortgages as a minimum requirement for plan confirmation. If *Nobelman* is allowed to stand, the prudent short-term lender would forego any security interest in personal property, preferring instead to obtain a deed of trust on the debtor's homestead regardless of value underlying the lien. This deed of trust provides the lender with an unalterable security position on the debtor's homestead. The creditor would be entitled to have its claim paid in full, thus insuring a greater protection in bankruptcy than afforded under Mississippi debtor-creditor law. The debtor is defeated before being afforded the fresh start supposedly provided by the Bankruptcy Code. The plan has a much higher rate of success if the debtor can avoid the liens not supported by actual value of the collateral. He must maintain and cure the arrearage of the first mortgage and is able to partially strip the lien of the second mortgage and fully avoid the third lien, treating these claims as all other unsecured

claims. Although the success of the debtor's financial rehabilitation is not assured, the debtor's chances are greatly improved.

In many rural states such as Mississippi, the first lienholder in numerous instances is the Farmers Home Administration. Because of the debtor's inability to service a second and/or third mortgage payment, the home is foreclosed upon after the automatic stay has been lifted in the bankruptcy case. Unless the first lienholder (FmHA) is paid off by the foreclosing second or third mortgagee, the property is placed into the already excessive inventory of property held by government agencies. The same result occurs if FmHA forecloses. An analogous situation arises when dealing with the Federal Housing Administration loans on real property when the United States government is required to honor its guaranty.

Since the Chapter 13 Trustee is under a duty to ascertain that all disposable income is disbursed to unsecured creditors, if the lien stripping is allowed, there is a greater likelihood of more disposable income for all creditors of the bankrupt estate. Instead of a creditor who in reality is unsecured but for the "valueless" lien, the monies proposed to this creditor should be paid to all unsecured creditors.

The Trustee urges this Court to recognize that the facts of *Nobelman* are atypical. In *Nobelman*, the creditor became undersecured as a result of the bottoming out of the economy in Texas. However, this Trustee would suggest that the majority of cases where lien stripping is an issue involve liens held by short-term consumer creditors who advanced monies in return for a junior lien position

with no investigation of property value and no real reliance on the value of the collateral to satisfy the lien. Certainly the same consumer creditor would receive nothing or very little as a result of a foreclosure sale under state law. Therefore, it appears inequitable that such a creditor would receive more in a chapter 13 case than other general unsecured creditors of the estate by simply being in a position to insist on a valueless deed of trust. To allow *Nobelman* to stand is to deny innumerable debtors the avenue of relief intended to be afforded by Chapter 13 of the Bankruptcy Code.

CONCLUSION

The Court should reverse the decision below and allow bifurcation of a claim secured only by the Debtors' principal residence into allowed secured and unsecured claims by applying all the Bankruptcy Code sections in an orderly fashion. There is simply no logical explanation to ignore Sections 103(a) and 506 of the Code in a Chapter 13 case.

Respectfully submitted,

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In the
Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,
Petitioners,

v.

AMERICAN SAVINGS BANK,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT.

[redacted] **Brief of Consumer Education and Protective Association, Ruby Lee Bradley, Ethel Cook, Clifford Moses, and Chapter 13 Trustee Gary Gaertner as Amici Curiae in Support of Petitioners.**

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INTERESTS OF AMICI CURIAE

Amici Ruby Lee Bradley, Ethel Cork and Clifford Moses are individuals who have filed bankruptcy cases under Chapter 13 of the Bankruptcy Code. They propose to strip down junior mortgages held solely on their homes. Their cases illustrate the illogical and inequitable results compelled by the decision of the court below, which forces consumer debtors in Chapter 13 cases to treat an unsecured or partially secured claim the same as a fully secured claim.

Mrs. Ruby Lee Bradley purchased her home in December, 1987. She owes $32,000 on the first mortgage. In May, 1989 she obtained a loan of $6,000 from Greentree Acceptance Company to have aluminum siding placed on her house. Although the home had not appreciated in value, Greentree took a second mortgage on the property.

Mrs. Bradley's current monthly income is $878.99 from a combination of wages and social security benefits for her dependents. She has six (6) children.

Mrs. Bradley cannot pay both the first and second mortgage on her home. She filed a Chapter 13 bankruptcy in the Northern District of Mississippi on July 27, 1992. The appraised market value of her home at that time was $29,500. Bradley's Chapter 13 plan proposes to pay the first mortgage of $32,000 in full. The second mortgage - which has never encumbered any property value - will be stripped down and treated as an unsecured claim. If the second mortgage is stripped down the monthly Chapter 13 payments would be $485.22. If the second mortgage must be treated as a fully secured claim the monthly Chapter 13 payments would be $600.22. Mrs. Bradley does not have

sufficient income to pay $600.22 a month into a Chapter 13 plan and meet her other living expenses. On the other hand, she can pay the proposed Chapter 13 payments of $485.22 per month and meet daily expenses. Thus, whether the second mortgage can be stripped down will determine whether Bradley can successfully complete a Chapter 13 plan.

The United States Bankruptcy Court denied confirmation of Bradley's Chapter 13 plan because it proposes to strip down the second mortgage. The bankruptcy court cited the decision of the court below in support of this ruling. Her case is on appeal to the United States District Court. The likelihood of success on appeal depends on the Court's decision in this case.

Ms. Ethel Cork purchased her home in 1984. She owes $36,000 on the first

mortgage. The monthly payments on the first mortgage are $555.00. In 1990 she obtained an $8,600 home improvement loan from Greentree Acceptance Company. That loan is repayable over fifteen (15) years at a 15% annual percentage rate of interest. Payments on this loan are $125.00 per month, and the total sum to be paid over fifteen (15) years is $22,000. Although Cork's home had not appreciated in value, Greentree took a second mortgage on the property.

Ms. Cork has a fixed income of $800.00 a month in social security benefits. She is unable to make the payments on both the first and second mortgages on her home. On November 18, 1992 she filed a Chapter 13 bankruptcy in the Northern District of Mississippi. The appraised market value of her home when she filed was $32,500. Ms. Cork is not

behind on the first mortgage of $36,000 and her Chapter 13 plan proposes to maintain payments on the first mortgage. She is, however, approximately $3,000 in arrears on the second mortgage. Ms. Cork proposes to strip down the second mortgage and treat it as an unsecured claim. If the second mortgage cannot be stripped down, Ms. Cork does not have sufficient income to make payments in her Chapter 13 case on both mortgages. However, she has the ability to pay the first mortgage.

Mr. Clifford Moses purchased his home in 1985 for $10,000, financed by a mortgage for all or virtually all of the purchase price. Several years later he obtained a loan of $3,000 from a finance company. Although the home had not appreciated in value, the finance company took a second mortgage on the home. Mr. Moses experienced financial problems and

defaulted on both loans. He recently filed a Chapter 13 case in the Eastern District of Pennsylvania. The parties to that case recently stipulated that there was no equity over and above the first mortgage, and Moses' plan providing for the second mortgage claim as an unsecured claim is awaiting confirmation.

Absent the ability to strip down the second mortgage on his home, it is very doubtful whether Mr. Moses could save his home in bankruptcy, since he does not have sufficient income to cure or pay off both his first and second mortgages. Yet, under the decision of the court below, that would be the only way to deal with both debts in a Chapter 13 case.

Mrs. Bradley, Ms. Cork and Mr. Moses are low-income homeowners. They have sufficient income to protect their homes in Chapter 13 proceedings by paying the

first mortgage claim. They seek reversal of the decision below which would deprive them of the protection of Chapter 13. They should not lose this protection by being forced to pay junior mortgages that do not encumber any value in their homes.

Amicus Consumer Education and Protective Association, Inc. (CEPA) is a membership organization of primarily low-income consumers based in Pennsylvania. CEPA is dedicated to advancing the cause of consumer rights, and in particular, the support and protection of those statutory remedies designed to enable economically distressed homeowners to save their homes from foreclosure. Chapter 13 of the Bankruptcy Code has enabled hundreds of CEPA's members to address the burden of their debt, including, most critically, the opportunity to set up affordable payment plans for curing defaults on their

home mortgages.

CEPA's particular interest in this case is that a decision requiring full payment of undersecured claims would substantially increase the burden that Chapter 13 places on low-income debtors and, in many cases, would put this remedy beyond the reach of its members who, but for the added payment requirement, could save their homes.

Amicus Gary J. Gaertner is the Chapter 13 Standing Trustee in the United States Bankruptcy Court for the Western District of Pennsylvania. He has the statutory duty to review and administer Chapter 13 plans and to represent the interest of the bankruptcy estate. During 1992 he had 1,734 open cases and distributed $10,777,379 to creditors. Of that amount, $7,398,277 was paid to secured creditors. The Chapter 13 Trustee

has the additional responsibility to oppose preferential treatment in a Chapter 13 plan favoring a subclass of unsecured claims. Affirmance of the Fifth Circuit's decision would result in discrimination in favor of a subclass of unsecured claims (i.e., the unsecured portions of undersecured claims), when there is no economic, statutory or rational social policy reason to do so. Mr. Gaertner believes that an affirmance of the Fifth Circuit's decision would also create undue pressure on debtors to liquidate under Chapter 7 by forcing them to pay for illusory "secured" debt, when they could reorganize and pay under a Chapter 13 plan based on economic realities. Such an outcome would be contrary to Congress' intent in revising the Bankruptcy Code to encourage the use of Chapter 13.

ARGUMENT

SUMMARY OF ARGUMENT

The correct interpretation of sections 506(a) and 1322(b)(2) of the Bankruptcy Code should start and end with their plain language. The natural reading of these sections is that the ban against modification found in section 1322(b)(2) applies only to the portion of the claim that has secured status after application of section 506(a).[1]

The decision of the Fifth Circuit below, Matter of Nobleman, 968 F.2d 483 (5th Cir. 1992), found conflict between

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[1] This is the interpretation adopted by the Second, Third, Ninth and Tenth Circuits. In re Hougland, 886 F.2d 1182 (9th Cir. 1989), reaffirmed in Lomas Mortgage U S A v. Wiese, ___ F.2d ___, 61 USLW 2364 (9th Cir. 1992); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3d Cir. 1990), reaffirmed in Sapos v. Provident Inst. of Savings in Town of Boston, 967 F.2d 918 (3d Cir. 1992); In re Bellamy, 962 F.2d 176 (2d Cir. 1992); In re Hart, 923 F.2d 1410 (10th Cir. 1991).

§§ 506(a) and 1322(b)(2) that does not exist. There is no conflict because, even after a creditor's claim has been stripped down by application of § 506(a), the creditor is protected by § 1322(b)(2) against modification of rights that flow from the underlying transaction, such as the interest rate and payment schedule.

The interpretation urged by amici carries out the Congressional compromise embodied in § 1322(b)(2) without undermining the fundamental purposes of the Bankruptcy Code of providing a fresh start for the honest debtor and equity among similarly situated creditors.

Section 506(a) is a crucial tool in fulfilling the intent of Congress that rights in bankruptcy be based on economic reality, without extraneous non-financial pressures. Congress intended that § 506(a) have uniform application

throughout the Bankruptcy Code. Application of § 506(a) results in a recognition of the underlying economic reality, not a modification of any property rights. These sections can be harmonized by having the special protection for home mortgage lenders in § 1322(b)(2) apply only to the portion of the claim that has economic value. This interpretation honors Congress' intention that the Code be based on economic reality.

Applying the plain language of the Code has not and will not lead to the dire consequences that the home mortgage lending industry has conjured up. Because § 506(a) does not destroy real economic value, the ability to strip down home mortgages by using § 506(a) has not had any economic impact on the mortgage lending market.

If the court below is affirmed, however, creditors who hold claims backed by no real value will be able to impair homeowners' opportunity for a fresh start, and will receive preferential distribution compared to similarly situated unsecured creditors.

To prevent such mischief, and to preserve the careful balance of rights in the Bankruptcy Code, the decision of the court below should be reversed.

I. THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE ALLOWS BIFURCATION OF ANY CLAIM IN A CHAPTER 13 CASE

This case involves the interpretation of 11 U.S.C. §§ 506 and 1322(b)(2). The plain meaning of these sections is that the § 1322(b)(2) prohibition against modification applies only <u>after</u> a determination of whether a claim is a secured claim pursuant to § 506(a).

"[W]here, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241 (1989) (quoting Caminetti v. United States, 242 U.S. 470, 485 (1917)); Patterson v. Shumate, 504 U.S. ___, 112 S.Ct. 2242, 2247 (1992); Toibb v. Radloff, 501 U.S. ___, 111 S.Ct. 2197, 2199 (1991).

A. Sections 506(a) and 1322(b)(2) Do Not Conflict, and These Sections Can Be Harmoniously Applied in a Chapter 13 Case

The interpretation of §§ 506(a) and 1322(b)(2) begins with the definition of "secured claim". A "claim" is a right to payment from the debtor, or property of the debtor. 11 U.S.C. §§ 101(5)(A), 102(2). See Johnson v. Home State Bank, 501 U.S. ___, 111 S.Ct. 2150 (1991). The

meaning of "secured claim" is found in 11 U.S.C. § 506(a). Section 506(a) provides that a claim that exceeds the value of the collateral is bifurcated, or stripped down, into a secured claim and an unsecured claim. "[s]ubsection (a) of § 506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured." Ron Pair, 489 U.S. at 239. Section 506, like all provisions of Chapter 5 of the Code, applies in Chapter 13 proceedings. "[C]hapters 1, 3, and 5 of this title apply in a case under Chapter 7, 11, 12, or 13 of this title." 11 U.S.C. § 103(a).

In a Chapter 13 case, the debtor's plan may modify the rights of holders of secured or unsecured claims, with one exception. Section 1322(b)(2) describes

the permissible contents of a plan as follows:

> (b) Subject to subsections (a) and (c) of this section, the plan may . . .
>
> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

11 U.S.C. § 1322(b)(2). Nothing in § 1322(b)(2) states that § 506(a) does not apply when the collateral is the debtor's principal residence. Despite the lack of any such language, the court below adopted the respondent's argument that in a Chapter 13 case § 506(a) does not apply at all to an undersecured creditor who holds a security interest in the debtor's principal residence.

The court below stated that the "no modification" provision of § 1322(b)(2) "appears to conflict with § 506(a)."

Nobleman, 968 F.2d at 488 (emphasis added). Without further examination of whether these two sections actually conflict, the court below then held that the "specific" language of § 1322(b)(2) would prevail over the "general" language of § 506(a). Nobleman, 968 F.2d at 488. The court below ignored its duty to construe these sections to avoid a conflict if possible. See United Savings Association v. Timbers of Inwood Forest, 484 U.S. 370, 371 (1988) (apparently ambiguous language may be clarified when viewed in context of statutory scheme as a whole); Pittsburgh & Lake Erie Ry. Co. v. Railway Labor Executives Ass'n, 491 U.S. 490, 510 (1989) (whenever possible, statutes should be construed so as to avoid a potential conflict).

The court below erred because there is no genuine conflict between §§ 506(a)

and 1322(b)(2). Both sections can be given effect in the same case. Application of § 506(a) results in a finding of how much of a claim is a secured claim. Once that determination is made, then § 1322(b)(2) prevents modification of the rights associated with that claim, such as the interest rate and payment schedule, if the claim is secured only by a security interest in the debtor's home. Bellamy, 962 F.2d at 198; see also, In re Hayes, 111 B.R. 924, 926-28 (Bankr. D. Or. 1990). As the Ninth Circuit correctly observed, these sections "are in harmony when read in the context of the whole statute." Hougland, 886 F.2d at 1184.

The court below adopted an unnatural reading of the statute. It said that the subject matter of § 1322(b)(2) was "the modification of 'the rights of holders of'

claims",[2] rather than the modification of secured "claims". Nobleman, 968 F.2d at 488. The court then construed § 1322(b)(2) to be a prohibition against modification of any of the rights of an entity that is the holder of a secured claim on the debtor's principal residence, including its rights as a holder of an unsecured claim. The more natural reading, adopted by the Ninth Circuit in Hougland, and by the Second, Third and Tenth Circuits, is that the words "other than", refer to their immediate antecedent, "secured claims", and apply only to that portion of the claim that is secured. Therefore, the ban on modification applies to only the secured portion of a claim.

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[2] The court below omitted the word "secured" before "claims" in its quotation of the statute.

Moreover, the method of interpretation used by the court below does not lead to a clear result. Its dissection of the statute fails to account for the placement of the words "holders of unsecured claims" after the "no modification" phrase. An undersecured creditor is, literally, a "holder of an unsecured claim", as well as a holder of a secured claim. There is no language prohibiting modification following the words "holders of unsecured claims". Consistent application of the method of analysis of the court below would allow modification of all of the rights of any entities that are "holders of unsecured claims." A secured creditor who does not also hold an unsecured claim (i.e., a fully secured creditor) is protected from modification; an undersecured creditor whose only security is the debtor's home

could nevertheless have both the secured and the unsecured portions of its claim modified. Thus, the approach that focuses on the creditor, rather than the claim, takes back with one phrase virtually all of what was given with another. This result is illogical and incorrect.

If Congress had meant to protect creditors, rather than claims, it would have referred to creditors "secured only by a security interest in real property that is the debtor's principal residence", instead of claims that are so secured. The use of the word "claims" was part of a consistent design by Congress in the Bankruptcy Code to tailor the rights of secured creditors to their actual economic interests, as opposed to their nominal status as secured creditors. See § II.B., infra. Thus references to "creditors", as opposed to "holders of claims" are rare by

design, not accident. The Code deliberately focuses on the nature of the claim, and not on the identity of the creditor. However, Congress knew how to refer to creditors, as opposed to holders of claims, when that was its intent. See, e.g., 11 U.S.C. § 509 (subrogation rights of codebtors who pay claims of "creditors"); § 523(c)(1) ("creditors" must follow certain procedures to except the debts owed to them from discharge).

There is, therefore, no reason to believe that the phrases "secured claim" and "unsecured claim" in § 1322(b) have any meaning other than those given to them by § 506(a).

B. Congress Created an Express Exception to Stripdown in 11 U.S.C. § 1111(b) and Could Have Done the Same If It Intended to Protect Holders of Residential Mortgages From Stripdown in Chapter 13.

If Congress had intended to create an

exception to stripdown in Chapter 13 for residential mortgage holders, it certainly knew how to do so. Congress enacted an express exception to stripdown in 11 U.S.C. § 1111(b), which provides, in pertinent part:

> (1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under Section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless-
>
> (i) The class of which such claim is a part elects . . . application of paragraph (2) of this subsection . . .
>
> (2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

(emphasis added).[3]

Congress' failure to include language in

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[3] For an explanation of § 1111(b), see Howard, Stripping Down Liens: Section 506(d) and the Theory of Bankruptcy, 65 Am. Bankr. L.J. 373, 398 (Spring, 1991).

§ 1322(b)(2) that specifically refers to § 506(a), after it had included such language in § 1111(b)(2), supports the conclusion that the additional protection Congress provided for residential mortgage holders in § 1322(b)(2) does not include insulation from stripdown in Chapter 13.

C. This Court's Decision in Dewsnup v. Timm Does Not Support the Decision of the Court Below.

Although the court below found support for its position in this Court's decision in Dewsnup v. Timm, 502 U.S. ___, 112 S.Ct. 773 (1992), there is only a superficial similarity between the cases. Indeed, after describing Dewsnup, the Court below did not explain why Dewsnup was relevant to this case. See Nobleman, 968 F.2d at 487.

Dewsnup's interpretation of §§ 506(a) and 506(d) in Chapter 7 cases is neither

dispositive nor particularly helpful in cases filed under the reorganization chapters. The issue in Dewsnup was whether a Chapter 7 debtor could use §§ 506(a) and 506(d) to strip down a lien. There is no dispute that a reorganizing debtor in Chapter 11 or 12 can strip down any lien[4], and that a Chapter 13 debtor can strip down any lien other than a lien secured only by the debtor's principal residence. In Dewsnup this Court was reluctant to change prior practice without a clearer indication of legislative intent. It is clear, however, that Congress contemplated that liens would be stripped down in the reorganization chapters. See 124 Cong. Rec. H11107 (Sept 28, 1978) (remarks of Rep. Edwards); 124

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[4] Subject to the possibility of a § 1111(b)(2) election. If stripdown were not allowed in a Chapter 11, § 1111(b)(2) would be superfluous.

Cong. Rec. S17424 (Oct 6, 1978) (remarks of Sen. DeConcini) (secured creditor's lien retained under § 1325(a)(5) only secures the value of the collateral and is satisfied in full by plan payments equal to present value of allowed secured claim). See also, H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977), discussed infra at 32. Since the issue in this case is the scope of an exception to what all parties agree is the general rule allowing lien stripping, nothing in Dewsnup's interpretation of § 506 gives any guidance in this case.

In Dewsnup this Court cautioned that its decision was limited to lien stripping in a Chapter 7 case. Dewsnup, 502 U.S. at ____, 112 S.Ct. at 778, n.3. The failure of the court below to heed this warning led it to the incorrect result in this case.

II. THE DEBTORS' POSITION IS SUPPORTED BY THE OVERALL SCHEME OF THE BANKRUPTCY CODE AND BY THE LEGISLATIVE HISTORY

It has long been recognized that the fundamental purposes of the bankruptcy laws are to provide a fresh start for honest debtors and to ensure equity of treatment among similarly situated creditors. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., Pt.I. 75 (1973). These purposes permeate the Bankruptcy Code, including § 506. H.R. Rep. No. 545, 95th Cong. 1st Sess. 340, 429, 118, 124 (1977).

A. 11 U.S.C. § 506 Plays an Indispensable Role in the Overall Scheme of Chapter 13 Which Would Be Undermined If the Respondent's Position Is Adopted.

1. The Purpose of § 506 Is to Recognize the Economic Reality of an Undersecured Creditor's Position, Vis a Vis the Debtor and Other Creditors.

Congress revised § 506(a) with both

the debtor's fresh start and the principle of equity among creditors in mind. The House Report states:

> One of the more significant changes from current law in proposed title 11 is the treatment of secured creditors and secured claims. Unlike current law, H.R. 8200 distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is those creditors who are undersecured. Current law is ambiguous and vague, especially under chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an unsecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.
>
> The new treatment of secured claims, especially the bifurcation of the claims into secured and unsecured claims, has important protective consequences for both creditors and the debtor. For the creditor, the bill requires that once the secured claim is determined, the court must insure that the holder of the claim

> is adequately protected. The secured creditor is entitled to realize his claim, and not have his collateral eroded by delay or by use by the estate. For the debtor, the determination of the amount of the secured claim facilitates reorganization in the business context, and repayment plans in the consumer context, by defining the precise extent of the claims against the debtor that must be treated specially as secured claims.
> * * *
>
> Because of the uncertain treatment of secured creditors under current law, the debtor is often required to err on the side of overprotection when formulating a reorganization or repayment plan. Secured creditors have exercised great leverage by virtue of the uncertainty, and have made reorganization and individual repayment plans more difficult to consummate than would be the case under this bill. Since a successful reorganization or chapter 13 plan inures to the benefit of all creditors, the change under the bill should increase recoveries by creditors generally.

H.R. Rep. No 595, 95th Cong., 1st Sess. 180-81 (1977) (footnotes omitted).

The importance of § 506(a) is that it

imports into virtually every aspect of bankruptcy law the economic reality of what a security interest is actually worth. A creditor with a security interest, in addition to potential unsecured rights under a loan note, has the right to foreclose or otherwise execute on the security to obtain repayment. However, the security interest is only as good as the underlying collateral.

For example, a $100,000 home may serve as security for an $80,000 first mortgage, a $40,000 home equity loan secured by a second mortgage, and a $30,000 home equity "line of credit" secured by a third mortgage. If the first mortgagee forecloses, it would obtain the full amount of its claim in the foreclosure process. If the second mortgagee forecloses, the first mortgagee

would be paid off, and the second mortgagee would obtain only $20,000 from sale of the property, less any transaction costs. As to the remaining balance, the second mortgagee would then be in the same position as a creditor who never was secured, because it would need to look to the mortgagor's other assets for any deficiency. The third mortgagee could realize nothing by foreclosure, and is nothing more than a completely unsecured creditor.

11 U.S.C. § 506(a) recognizes this economic reality when valuing nominally secured claims. Holders of secured claims get only the equivalent of what they would have received if they had foreclosed. If they were undersecured, the unsecured portions of their claims are treated the same as any other unsecured claims.

No unfairness results, because

creditors get the economic value of their security, all unsecured claims are treated equally and the debtor gets the benefit of a fresh start free of the unjustified leverage which a retained, but economically valueless security interest represents. As stated in the House Report:

> Current chapter XIII does little to recognize the differences between the true value of the goods and their value as leverage. Proposed chapter 13 instead views the secured creditor-debtor relationship as a financial relationship, and not one where extraneous, non-financial pressure should enter. The bill requires the court to value the secured creditor's interest. To the extent of the value of the security interest, he is treated as having a secured claim, entitled to be paid in full under the plan, unless, of course, he accepts less than full payment. To the extent that his claim against the debtor exceeds the value of his collateral, he is treated as having an unsecured claim, and he will receive payment along with all other general unsecured creditors. Of course, the holder of a non-recourse loan will not have an unsecured claim for the deficiency.

> This is an important departure from a few misguided decisions under current law, under which a secured creditor with a $2,000 secured by household goods worth only $200 is entitled in some cases to his full $2,000 claim, in preference to all unsecured creditors.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977) (footnotes omitted).

The principles embodied in § 506(a) are so paramount in the Bankruptcy Code that this Court should not find that § 506(a) is negated by some other section, such as § 1322(b)(2), without clear evidence that Congress specifically intended to limit the effect of § 506(a).

2. The Decision of the Court Below Would Make It Possible for Creditors to Circumvent the Bankruptcy Discharge

If the decision of the court below is affirmed, the fresh start that Congress enhanced and protected when it enacted the Code would be vulnerable to wily

creditors. A creditor lending to a homeowner could easily circumvent the discharge by simply taking a mortgage in the transaction. Under the decision below, that mortgage would allow the creditor to demand full payment with interest, even if the mortgage was, in real economic terms, totally worthless, despite the discharge. Such an outcome would severely undermine the potential relief available in bankruptcy, would subvert the reforms enacted in the Bankruptcy Code and would frustrate the debtor's fresh start.

Nothing in the language of the Code compels such a result so at odds with its fundamental purpose of providing a fresh start. It is difficult to believe that Congress intended to permit creditors to obtain so easily what, in effect, would be an advance waiver of the discharge

protections. Considering the elaborate scheme in the statute protecting debtors who might consider reaffirming debts that are dischargeable, 11 U.S.C. §§ 524(c), (d), it is inconceivable that Congress would in the same enactment permit a creditor to achieve the same result as it could through reaffirmation through the device of having the debtor sign a worthless mortgage on totally encumbered property. This is especially so when in another section Congress protected debtors from the in terrorem tactics of creditors holding nonpossessory, nonpurchase-money security interests in household goods. 11 U.S.C. § 522(f). See H.R. Rep. No. 595, 95th Cong., 1st Sess. 126-27 (1977).

3. A Debtor's Chapter 13 Plan That Recognizes the Secured Value Determination Made in a Proceeding Brought Pursuant to § 506(a) Does Not Thereby Modify The Rights of An Undersecured Creditor

Bankruptcy law by its very existence creates numerous modifications of creditors' rights under credit contracts and state law. Clearly Congress did not intend a blanket protection from every provision of the Code for residential mortgage holders. See, e.g., Bellamy, 962 F.2d at 181-82.

The logical conclusion of the respondent's position is that all provisions of Chapters 1, 3 and 5 of the Bankruptcy Code which incidentally modify the rights of residential mortgage holders must be inapplicable to their claims in Chapter 13. But this proves too much. For example, the automatic stay provisions of the Code are found in Chapter 3 of the Bankruptcy Code at 11 U.S.C. § 362. The automatic stay unarguably modifies secured creditors' rights by preventing inter alia a creditor from exercising its rights to

the collateral while the stay is in effect. 11 U.S.C. §§ 362(a)(3),(4). Timbers, 484 U.S. at 371-72.

The only thing which prevents the automatic stay from running afoul of the provisions of 11 U.S.C. § 1322(b)(2) is the language limiting the applicability of that provision to the contents of the debtor's plan. That is, it is not the plan which creates the modification of rights caused by the automatic stay, but rather another provision of the Bankruptcy Code. Consequently, no one would seriously argue that § 1322(b)(2) trumps the automatic stay so that a residential mortgage holder may exercise a right to the collateral while the stay is in effect. Similarly, bifurcation of a claim under 11 U.S.C. § 506(a) is not initiated or effectuated as part of the debtor's plan. Thus stripdown occurs not

as the result of a plan provision, but rather based on application of a wholly separate substantive provision of the Bankruptcy Code. In fact, a number of cases have held that a Chapter 13 plan provision is an inappropriate means to effect a stripdown of any creditor's claim. See, e.g., In re Calvert, 907 F.2d 1069 (11th Cir. 1990).[5]

Since § 1322(b)(2) only limits what the plan can provide, there is no textual basis in § 1322(b)(2) for precluding the debtor from obtaining a § 506(a) valuation. Once a valuation resulting in

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[5] The exact procedure for stripdown is unclear, with some courts requiring an adversary complaint, Fed R. Bankr. P. 7001(2), and others requiring a motion for valuation under Fed. R. Bankr. P. 3012. Compare, e.g., In re Jablonski, 70 B.R. 381 (Bankr. E.D. Pa. 1987), and In re Caster, 77 B.R. 8 (Bankr. E.D. Pa. 1987) (complaint required), with In re Calvert, 907 F.2d 1069, 1072 (11th Cir. 1990), and In re Windfelder, 82 B.R. 367, 370 (Bankr. E.D. Pa. 1988) (motion required).

bifurcation has occurred, a Chapter 13 plan's modification of the unsecured portion of the bifurcated claim does not impinge upon a secured claim, and does not violate § 1322(b)(2).

B. The Applicable Legislative History Supports Use of Stripdown in Residential Mortgages

As discussed above, this case may be resolved in favor of the debtors' position on the basis of the plain language of the Code alone. In addition the weight of the legislative history strongly supports amici's plain language interpretation.

The court below stated that its interpretation of § 1322(b)(2) was consistent with the legislative history of that section. But the same can be said for debtors' position, since it too provides greater protection for qualified home mortgage lenders. Bellamy, 962 F.2d at

181-82 ; Hougland, 886 F.2d at 1184.

If the legislative history of both §§ 506 and 1322 is examined, it supports amici's analysis of the interplay of these two sections and not that of the court below.

As discussed supra at § I.A., the court below went astray when it focused on the status of an entity as a holder of a secured claim, rather than on the secured claim. The legislative history shows that the use of the word "claim" was part of a consistent design by Congress in the Code to tailor the rights of secured creditors to their actual economic interests, as opposed to their nominal status as secured creditors.

The discussion of § 506(a) in the accompanying Senate Committee Report states this clearly.

Section 506. Determination of secured

status.
Subsection (a) of this section separates an undersecured creditor's claim into two parts: He has a secured claim to the extent of the value of his collateral; and he has an unsecured claim for the balance of his claim.
* * *
Throughout the bill, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim. This provision abolishes the use of the terms "secured creditor" and "unsecured creditor" and substitutes in their places the terms "secured claim" and "unsecured claim."

S. Rep. No. 989, 95th Cong. 2d. Sess. 68 (1978).

Section 506(a) of S. 2266 was identical (except for a comma) to § 506(a) as enacted. See also H.R. Rep. No 595, 95th Cong., 1st Sess. 180-81 (1977). The emphasis in the legislative history of the significance of the word "claim" instead of "creditor" supports amici's plain language analysis of §§ 506(a) and 1322(b)(2).

C. Congress Has Expressed an Awareness That § 1322(b)(2) Does Not Prevent Stripdown of Residential Mortgages.

In post-enactment legislative history, Congress has clearly expressed a belief that stripdown of residential mortgage liens is available in Chapter 13 cases notwithstanding § 1322(b)(2).[6] In 1992, both houses of Congress passed bills which would have amended § 1322(b)(2) to protect some, but not all, residential mortgage liens from the effects of § 506(a) stripdown.[7] S. 1985 would have protected all "primary" security interests and "junior security interests" to the extent they were secured at the time the security interest attached.[8] H.R. 6020 would have protected only the most senior security interest on the property, to the extent it was secured at the time the interest attached.[9]

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[6] This Court has used post-enactment legislative history to interpret statutes. E.g., Anderson Brothers Ford v. Valencia, 452 U.S. 205, 212-19 (1981).

[7] The Senate and House of Representatives passed different bankruptcy bills in 1992. Neither was enacted into law.

[8] S. 1985, §310, 102d Cong. 2d Sess. (1992). That provision reads:

> Section 1322(b)(2) of title 11, United States Code, is amended by striking "claims;" and inserting "claims, but the plan may not modify a claim pursuant to section 506 of a person holding a primary or a junior security interest in real property or a manufactured home (as defined in section 603(6) of the National Manufactured Housing Construction and Safety Standards Act of 1974 (42 U.S.C. 5402(6)) that is the debtor's principal residence, except that the plan may modify the claim of a person holding such a junior security interest that was undersecured at the time the interest attached to the extent that the interest remains undersecured;".

[9] H.R. 6020, § 202 102d Cong., 2d Sess. (1992). That provision stated:

> PRESERVATION OF HOME MORTGAGE LIENS. Section 1322(b)(2) of title 11 United States Code, is amended -
> (1) by striking ", other than a claim secured only by a security interest

(continued...)

This post-enactment legislative history reflects Congressional awareness that current law permits stripdown of all residential mortgages. It also represents a determination in each house of Congress that stripdown of many residential mortgages should continue to be permitted. Although post-enactment legislative history does not control the result in this case, it contributes to the conclusion that Congress did not intend to exclude residential mortgages from the

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[9](...continued)
in real property that is the debtor's principal residence,", and
(2) by inserting before the semicolon at the end the following:
", except that the rights of the holder of a claim secured only by the most senior security interest in real property that is the debtor's principal residence may not be modified to reduce the secured claim to a value that is less than the value, as of the date the security interest arose, of the creditor's interest in the estate's interest in such property".

application of § 506(a) when it enacted § 1322(b)(2).

The legislative history does not support the claims made by respondent and amici urging affirmance that Congress clearly intended § 1322(b)(2) to preclude stripdown of residential mortgages. Furthermore, their attempts to have the courts legislate in this area are misguided. Their arguments have been made to Congress, See § III.C., infra, and should be resolved by Congress, not by this Court.

III. THE DECISION BELOW SUBVERTS THE FUNDAMENTAL PURPOSES OF THE BANKRUPTCY CODE

The decision of the court below makes it more difficult for Chapter 13 debtors to save their homes from foreclosure, thus frustrating the goal of a fresh start for the honest debtor. It also subverts the

goal of equity between similarly situated creditors. The argument that debtors' loss of their homes, and the violation of basic bankruptcy principles, is justified by larger policy concerns is not supported by empirical data.

A. Prohibiting the Stripdown of Undersecured Mortgages Would Make it More Difficult For Families to Save Their Homes Through Bankruptcy

Probably the most common and important reason that a debtor chooses to file a Chapter 13 case rather than a Chapter 7 case is to use the provisions that Congress placed in Chapter 13, but not in Chapter 7, which permit debtors to cure or pay off home mortgage debts. A decision by this Court affirming the court below would make it more difficult and, in some cases, impossible, for families to save their homes through Chapter 13, and push more debtors towards Chapter 7. This

would be contrary to Congress' intent when it enacted the Bankruptcy Code, which was to make Chapter 13 more available for saving homes from foreclosure. Collier on Bankruptcy, ¶ 1322.09[2].

The frequent use of Chapter 13 to save families' homes is well known. In Matter of Brunson, 87 B.R. 304, 307 (Bankr. D.N.J. 1988), the court noted that 70% to 80% of the Chapter 13 cases filed in New Jersey represented debtors' attempts to save their homes. A recent comprehensive study of bankruptcy debtors states that "the picture of homeowners in bankruptcy is one of people struggling to keep their homes." Sullivan, Warren and Westbrook, As We Forgive Our Debtors 143 (1989).

In a typical Chapter 13 plan, the bulk of the debtor's disposable income is used to cure or pay off a home mortgage.

The remaining income goes first to pay other secured debts in full, and only at the end to the holders of unsecured claims. See 11 U.S.C. §§ 1322(b)(5), 1325(a)(5) and 1325(b). Even in the Western District of Pennsylvania, where stripdown of home mortgages has been practiced for many years, over two-thirds of the distributions made in 1992 by amicus Gary J. Gaertner, the Standing Chapter 13 Trustee for that District, were to secured creditors, principally for home mortgages.

In many cases debtors have barely enough income to deal with their mortgage obligations through the Chapter 13 plan. In cases where mortgage stripdown is at issue, there is by definition no equity in the debtor's principal asset, the home, and so it is unlikely that the "best interests" test, 11 U.S.C. § 1325(a)(4),

would require substantial payments to unsecured creditors before the debtor obtained a discharge. 11 U.S.C. §§ 1325(a)(4), 1328. See generally Collier on Bankruptcy ¶¶ 1325.05, 1328.

In contrast, a creditor holding a secured claim that is to be paid under a Chapter 13 plan[10] is entitled to demand that its allowed secured claim be paid in full, with "present value" interest to compensate for the deferral of payments, or that any defaults be cured and all postbankruptcy payments be made. 11 U.S.C. §§ 1322(b)(3),(5), 1325(a)(5). See Collier on Bankruptcy ¶¶ 1322.07, .09;

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[10] Instead of paying a secured creditor through the plan, a debtor may surrender the collateral, or choose not to deal with a secured creditor in the plan. However, such a creditor may obtain relief from the automatic stay to foreclose on its collateral or exercise other nonbankruptcy remedies. See Collier on Bankruptcy ¶ 1325.06[2][b].

1325.06[2][c]. The bankruptcy court may decline to confirm a plan that does not meet one of these requirements.[11]

The significance of these principles to the case before the court is demonstrated by the circumstances of amicus Clifford Moses. Mr. Moses first purchased his home in 1985 for $10,000, financed by a purchase money mortgage for all or virtually all of the purchase price. Several years later he obtained a loan of $3,000 from a finance company. Although the home had not appreciated in value, the finance company took a second mortgage on the property. When Mr. Moses recently experienced financial problems, he defaulted on both loans and filed a

[11] However, if a creditor fails to object to confirmation it may be deemed to have waived this right or accepted the plan and the plan may be confirmed. In re Szostek, 886 F.2d 1405 (3d Cir. 1989). See also Collier on Bankruptcy ¶ 1325.01[1].

Chapter 13 case. Under the governing law in the Third Circuit, he then sought a valuation of his property so that the secured status of the second mortgage could be determined pursuant to § 506(a). The parties recently stipulated that there was no equity over and above the first mortgage, and the debtor's plan providing for the second mortgage claim as an unsecured claim now awaits confirmation.

Absent the ability to strip down the second mortgage on his home, it is very doubtful whether Mr. Moses could save his home in bankruptcy, since he does not have sufficient income to cure or pay off both his first and second mortgages. Yet, under the decision of the court below, that would be the only way to deal with both debts in a Chapter 13 case. As the holder of a secured claim, the second mortgage holder could demand payment in

full, with interest, and threaten to scuttle the Chapter 13 case, even though in reality it is nothing more than an unsecured creditor. The ability to hold a Chapter 13 plan hostage would give this creditor undue bargaining power in view of its totally unsecured position.

The situation of Mr. Moses is common, and is mirrored in the situation of amici Ruby Lee Bradley and Ethel Cork. Mrs. Bradley and Ms. Cork both gave second mortgages as security for home improvement loans that have added little if any value to their homes. Neither can afford to pay both the first and second mortgage payments on their homes.

Mrs. Bradley could possibly win her appeal of the denial of confirmation of her Chapter 13 plan if she can show factually that her second mortgage is totally unsecured, and if she can then

prevail on her legal argument that, even under the decision of the court below, a holder of a security interest in a debtor's home who is not secured by any actual value does not qualify as the "holder of a secured claim" entitled to the special protection of § 1322(b)(2). However, if the holder of her second mortgage can show that it is secured in any amount, even one dollar ($1.00), under the decision of the court below she would have to pay the entire balance of the debt. The absurdity of this potential result shows the inherent flaws in the decision of the court below.

The decision of the court below would frustrate debtors' ability to save their homes and flies in the face of the Code's purpose of providing a fresh start.

B. The Decision of the Court Below Contravenes the Bankruptcy Code's Policy of Treating Similarly Situated Creditors Equally

Bifurcation of claims into their secured and unsecured components is an integral part of the Code's balance between the rights of secured and unsecured creditors. Timbers, 484 U.S. at 373. Bifurcation ensures that wholly unsecured creditors receive the same treatment for their claims as partially secured creditors receive for the unsecured portion of their claims.

In Timbers, relying both on the language and structure of the Code as well as pre-Code practice, the Court declined to adopt a result that would permit undersecured creditors to receive interest on their allowed secured claims before unsecured creditors received any payment. "To allow a secured creditor interest

where his security was worth less than the value of his debt was thought to be inequitable to unsecured creditors." (citing Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 164 (1946)). Timbers, 484 U.S. at 373.

In this case, an undersecured creditor seeks not simply interest on its secured claim, but also principal and interest on its unsecured claim, to be paid prior to any payment to unsecured creditors. If the creditor is successful in these efforts, this would violate the principle of equity among similarly situated creditors. Every additional dollar paid to an undersecured creditor delays or prevents a payment to the general unsecured creditors.

Bifurcation of claims in § 506(a) is designed to recognize the real world economic rights of creditors to the

debtor's property at the time of a bankruptcy case. Creditors are given the special treatment accorded by the Code to holders of secured claims only to the extent they have security that has economic value. Beyond that, the bankruptcy policy of equity among creditors dictates that they be treated identically with wholly unsecured creditors. The decision of the court below directly contravenes this fundamental bankruptcy policy.

C. Experience Has Demonstrated That the Ability of Debtors to Strip Down Mortgage Liens Has No Perceptible Effect on the Purchase Money Mortgage Market

The respondent and other mortgage lenders will undoubtedly argue, as they argued below and have argued to Congress, that permitting stripdown of home mortgages will have a grave impact on

credit markets, making mortgage lending riskier, driving up the costs of such credit, reducing its availability and frustrating the American dream of home ownership. History has proved this argument to have no factual basis.

Courts have permitted the stripdown of mortgages in bankruptcy since at least 1981. In re Tanner, 14 B.R. 933 (Bankr. W.D. Pa. 1981). Stripdown of mortgages has been uniformly allowed in the Eastern District of Pennsylvania for almost ten years, see, e.g., In re Caster, 77 B.R. 8 (Bankr. E.D. Pa. 1987); In re Spadel, 28 B.R. 537 (Bankr. E.D. Pa. 1983), in the Ninth Circuit since 1989, Hougland, and in the Third Circuit since early 1990. Wilson.

During this entire period, no evidence has ever been brought forth that the availability of stripdowns has had any

impact at all on the mortgage market. Since real estate values plummeted during this period and the number of bankruptcy cases reached record highs, if there ever was to be an impact it would have occurred during that time. And, in view of the enormous effort that mortgage lenders have put into litigation and lobbying on this issue, if there were any evidence of stripdown's adverse impact on the market, we can be confident that it would have been produced. In fact, as is well known, mortgage interest rates have dropped significantly.

The lack of an adverse impact from mortgage stripdowns is not surprising in light of economic realities.

In the first place, the number of Chapter 13 debtors who stripdown purchase money mortgages is relatively small. Homeowners rarely file bankruptcy unless

they are in danger of foreclosure or in serious financial distress. Even respondent does not contend that there is a horde of consumers without serious financial problems filing Chapter 13 cases simply to strip down liens. At any given time less than one percent of homeowners are facing foreclosure, and only a fraction of them will ever file a Chapter 13 bankruptcy.

Second, since most purchase money loans are made to consumers who have paid down payments of 5% to 20%, giving the lender an equity cushion, many loans that are in foreclosure are not eligible for stripdown.

Third, stripdown is no worse for the lender than the most likely alternative, foreclosure. Stripdown helps the buyer to stay in the home by paying what the property would be worth to a stranger to

the property, which is all the lender could expect if it foreclosed. Furthermore, the Chapter 13 debtor must make current payments or face dismissal or lifting of the automatic stay, while there may be a substantial fallow period if the lender forecloses and has to find a new buyer in a depressed market.

Finally, even in the case where a purchase money mortgage is stripped down due to a decline in the market, the lender or guarantor does not lose the entire investment. Thus, the impact on first mortgage lenders is not nearly as drastic as has been portrayed by their advocates.

The bigger impact of stripdown occurs in the cases of second, third and fourth mortgages, where often there was never any significant equity to encumber and the lender could never have realistically relied upon the property for the payment

of its claim. Such mortgages are valuable to creditors because they can be used to threaten families with foreclosure if payment is not made (despite the fact that foreclosure would be unlikely) or to try to obtain an advantage over other creditors in a subsequent bankruptcy case. No bankruptcy policy or public policy is served by protecting lenders in such cases.

CONCLUSION

For all the foregoing reasons, the decision of the Fifth Circuit should be reversed in favor of the position taken by the Second, Third, Ninth and Tenth Circuits.

Respectfully submitted,

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Attorneys for Amici Curiae

Supreme Court, U.S.
FILED
JAN 21 1993
OFFICE OF THE CLERK

No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

JOINT APPENDIX

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*Counsel of Record

Petition For Certiorari Filed October 13, 1992
Certiorari Granted December 7, 1992

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

JOINT APPENDIX

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   b. United States District Court, Northern District of Texas 9

   c. Court of Appeals for the Fifth Circuit 13

2. Relevant Pleadings and Opinions

   a. Opinion, Bankruptcy Judge Harold C. Abramson.....Appendix, Pet. Cert. 32

   b. Opinion, District Judge H. B. Sanders 129 B.R. 98 (D.C. N.D. Tex. 1991) Appendix, Pet. Cert. 16

3. Decision Sought to be Reviewed:

   Court of Appeals for the Fifth Circuit

   Nobleman vs. American Savings Bank, 968 F.2d 483 .....Appendix, Pet. Cert. 1

BANKRUPTCY COURT – NORTHERN DIST. of TEXAS
PETITION DOCKET 6/88

341 MEETING	CLAIM DEADLINE
10/4/90 @ 9:30	1/2/91
DISCHARGE HEARING	**523/727 COMPLNT**
/ /	/ /

DISTRICT	OFFICE	YR-DOCKET NO-JUDGE
0539	3	390-35116-HCA-13

DATE FILED	REOPENED	JOINT PETITION? T
08/06/90		No Asset Asset

NAME OF DEBTOR
Nobelman, Leonard

KA/DBA

SSAN OR TAX ID: 072-26-7667

NAME OF JOINT DEBTOR
Nobleman, Harriet Ann (sic)

AKA/DBA

SSAN OR TAX ID: 454-48-1163

ADDRESS OF DEBTOR
4748 Old Bent Tree Lane #507
Dallas TX 75287

ADDRESS OF JOINT DEBTOR

COUNTY: COLLIN TX CODE 48085

JUDGE: Abramson, Harold C. CODE: A351

TYPE OF CASE: Voluntary

NATURE OF DEBTOR: Wage Earner

COMMENCED UNDER: 13
FEE PAID: T

IF BUSINESS, FORM OF ORGANIZATION
N/A

ST. #OF CREDITORS. 1 to 15
ST. ASSETS (IN 000'S): Under 50
ST. LIAB. (IN 000'S): Under 50

TYPE OF BUSINESS: N/A

OF EMPLOYEES: N/A

OF EQUITY SECURITY HOLDERS: N/A

ATTORNEY FOR DEBTOR
Zyne, Rosemary J.
5430 LBJ Frwy., LB 33, #875
Dallas, TX 75240 214/960-7477

TRUSTEE
Truman, Tim
7001 Grapevine Hwy. #510
Ft. Worth, TX 76180

OTHER

ATTORNEY FOR TRUSTEE

FILED	DATE OF ENTRY	DOC. NUM-BER	RECORD
	8/06/90	1	Petition Filed
	8/06/90	2	Notice to Consumer Debtor(s)
	8/06/90	3	Mailing Matrix Filed Matrix Deficiency
			Matrix Deficiency Notice Issued
	8/06/90	4	Attorney's Disclosure of Compensation
			Application to Employ Counsel for Debtor
			List of Twenty Largest Unsecured Creditors
	9/07/90	7	Stmt of FinAffrs & Sch 8/31/90 or (Ch. 13 Stmt.)
			Schedule of Income and Expenditures
			Statement of Debtor's Intentions
			Appointment of Trustee and Trustee Acceptance
	9/18/90	9	Notice of § 341 Mtg. and § 524(d) or Confirm Hrg with Cert. of Mailing # of Notices:

			§ 341 Meeting Conducted & Rpt of Exempt Prop Debtor(s) Appeared: [ ] TRUE [ ] FALSE Trustee finds: [ ] Assets [ ] No Assets [ ] This is a change from § 341 Notice
9/07/90		8	8/31/90 Chapter 13 Plan Summary
			ORDER confirming Ch 13 Plan for ___ months
			Debtors(s) Modified Ch 13 Plan, Motion for valuation
	10/31/90		with notice of hearing Hearing date: 12/6/90
11/05/90		11	Hearing time: 1:30 p.m.
	8/02/91	37	Amended Mailing Matrix
			ORDER Dischg. of Debtor
			Not. of Dischg. Mailed # of Notices:
			Trustee's No-Asset Rpt. & Closing Application
			Trustee Final Report [ ] NO ASSET [ ] ASSET
			ORDER Closing Case
			ORDER Dismissing Case
			Not. of Dismissal Order # of Notices:
			ORDER Reopening Case
8/20/90	8/23/90	5	Notice of appearance filed by Murray Mortgage Co,

			Deborah Putman, Bankruptcy Manager, PO Box 809038, Dallas, TX 75380-9038. df
8/27/90	9/7/90	6	"T" mot to dism w/hrg 9/6/90 @ 9:00am. df
		7-8	FRONT df
10/10/90	10/24/90	10	Report of (adjrnd) 341 meeting. df
11/5/90	11/16/90	12	Mot. of Murray Mortgage Co. to lift stay & for adequate protection; Michael J. Schroeder, ATTY; 4131 N. Central expy, #1000; Dallas, Tx 75204. mjh
11/5/90	11/16/90	13	Objection of Murray Mortgage Co. to confirmation of Plan. mjh
11/6/90	11/16/90	14	NOT. OF HRG. on #12 above; set for 11/27/90 @ 9:15 am. mjh
11/13/90	11/16/90	15	C/S of #14 above. mjh
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11/15/90	11/28/90	17	Dbtrs response to lift stay moton filed by Murray Mortgage Co. df
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			demand for adequate protection filed by Debbie Putman, Murray Mortgage Co. df
11/27/90	11/28/90	20	Amended trustee's objection to confirmation. df
11/27/90	12/5/90	21	P/M re: lift stay-Murray Mortgage. df
12/4/90	1/8/91	22	Trial brief filed by atty for debtor. df
12/5/90	1/8/91	23	Trial brief in support of amended trustee's objection to confirmation filed by trustee. df
1/3/91	1/8/91	24	Motion for approval of an agreement pursuant to bk rule 4001(d) filed by Murray Mortgage Co, agent for American Savings Bank, atty: Michael J. Schroeder, 4131 N. Central Expwy Comerica Bank bldg, Suite 1000, Dallas, TX 75204. df
1/28/91	2/5/91	24	A/O conditioning continuance of auto stay as to Murray Mortgage Co, servicing agent for American Savings Bank, stay to remain in effect provided debtor complies with conditions of order with regard to R/P being Unit #507, bldg 5, and .67% common elements in

			Parkway Lane Condominiums, City of Dallas, Collin Co, TX. (HCA) cc: mld df
2/13/91	2/14/91	26	FINDINGS OF FACT and Conclusions of Law per conds. HCA. ea
3/5/91	3/7/91	27	TRANSCRIPT, hrg held 12/6/90. df
3/11/91	3/12/91	28	ORDER Denying conf of dbs' mod ch 13 plan. O'd Objs to conf of dbs' plan by tr & Murray Mortg Co is sustained, & conf of dbs' mod plan is denied. HCA c:mld rwm
3/21/92	3/21/91	20	Notice of appeal filed by Leonard and Harriet Nobleman re: order denying confirmation of dbs' modified chpt 13 plan eod 3/12/91 filing fee pd $105.00 le
3/21/91	3/21/91	30	C/M on ntc of appeal doc. #29 le
3/21/91	3/21/91	31	Not regarding appeals to the U.S. District Court mailed to Rosemary J. Zyne 3 Lincolon Centre, Ste. 875 5430 LBJ Frwy., LB 33 Dallas TX 75240 le
4/1/91	4/2/91	32	Designation of record on appeal and stmt of issues filed by Leonard and Harriet Nobleman, appellants w/c/s le

4/17/91	4/19/91	33	CA-3-91-0753-H copy of ltr of transmittal of record on appeal to the U.S. District Court re: order eod 3/12/91 doc. #28 le
5-9-91	5-20-91	34	Appellant's Statement of Costs by Atty for Db w/c/s jb
5-16-91	5-20-91	35	Affd in Support of Mtn for RFS re Toyota Motor Credit Corp (Jerry L'Hommedieu) by Marsha Dekan w/c/s jb
6/24/91	6/28/91	36	CA3-91-0753-H, MEMORANDUM OPINION & ORDER, AFFIRMED. Judge Sanders mjh
		37	Illegible
8-2-91	8-6-91	38	Ntc of Bkcy by Rosemary Zyne for Db w/c/s jb

APPEAL CLOSED

U.S. District Court
Northern District of Texas (Dallas)

CIVIL DOCKET FOR CASE #: 91-CV-753

Nobleman v. American Sav, et al, et al Filed: 4/17/91
Assigned to: Chief Judge Barefoot Sanders
Demand: $0,000 Nature of Suit: 422
Lead Docket: None Jurisdiction: Federal Question
Dkt# in Bk Ct is 390-35116-HCA-13

Cause: 28:1334 Bankruptcy Appeal

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HARRIET NOBLEMAN
appellant

Rosemary Jeanne Zyne, Attorney
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(See above)
[COR LD NTC]

v.

AMERICAN SAVINGS BANK
appellee

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Docket as of September 17, 1991 8:45 am

Page 1 NON-PUBLIC

APPEAL CLOSED
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3:91cv753 Nobleman v. American Sav, et al, et al

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Room 14A7
Dallas, TX 75242-1496
USA

214/767-0814
FTS 729-9180

Docket as of September 17, 1991 8:45 am

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APPEAL CLOSED
INTERNAL USE ONLY: Proceedings include all events.
3:91cv753 Nobleman v. American Sav, et al, et al

4/17/91	1	Letter from U.S. Bankruptcy Court transmitting bankruptcy record on appeal. (5) (cxb)
4/18/91	2	Letter transmitting bankruptcy record on appeal to presiding judge. CC to counsel, bankruptcy clerk and bankruptcy judge. Appellant's brief due 5/3/91 for Harriet Nobleman, for Leonard Nobleman (1) (all)
5/3/91	3	Appellant's BRIEF by Leonard Nobleman, Harriet Nobleman (15+) (all)
5/17/91	4	Creditor/Appellee's BRIEF by Murray Mortgage Co., as Servicing Agent for American Savings Bank. Appellant's reply brief due 6/3/91 for Harriet Nobleman, for Leonard Nobleman (15+) (all) [Entry date 05/21/91]
5/21/91	5	Appellee's BRIEF by Tim Truman, Standing Chapter 13 Trustee; Appellant's reply brief due 6/5/91 for Harriet Nobleman, Leonard Nobleman (15+) (all) [Entry date 05/22/91]
6/4/91	6	Appellant's BRIEF by Leonard Nobleman, Harriet Nobleman Appellee's brief due 6/19/91 for Tim Truman, for American Savings Bank (13) (all)

6/24/91	7	MEMORANDUM OPINION AND ORDER the Order of the USZ Bankruptcy Court for the Northern Dist. of Texas Dallas Divison, entered 3/12/91 is AFFIRMED. (signed by HBS-cpys to counsel-6/24 . . . copies to Bk Judge and Bk Office. (16)) (dph)
6/24/91	–	Case closed (mer) [Entry date 06/27/91]
7/24/91	8	NOTICE OF APPEAL by Leonard Nobleman, Harriet Nobleman, appellants, to U.S. Court of Appeals for the 5th Circuit from the Final Order of the District Court affirming the Bankruptcy Court's Denial of Confirmation of Appellants' Chapter 13 Plan of Reorganization entered on 6/24/91. Fee payment amount: $105.00 Receipt #35955 Appeal record due on 8/8/91 (klm)
7/24/91	–	Notice of appeal and certified copy of docket to USCA: [8-1] appeal (klm)
7/24/91	–	**Address labels only (klm)
8/5/91	–	USCA Case Number, RE: [8-1] appeal USCA NUMBER: N.O.#91-1796 (klm)
8/7/91	–	Transmitted record on appeal to U.S. Court of Appeals: Case Papers – 2 Volumes, 1 vol. Bankruptcy Papers. [8-1] appeal (klm)
8/7/91	–	**Address labels only (klm)

Docket as of September 17, 1991 8:45 am

4/17/91

SUBJECT
- CRIM
- PRIS. w/
- PRIS. w/out
- 2255 w/
- 2255 w/out
- SOC. SEC.
- NLRB
- P.C. DIV.
- P.C. FED
- U.S. CIV
- TAX COURT

XX BKCY
- Oth Agcy Review
- CIVIL RIGHTS
- TAX D.C.
- SCHOOL
- CROSS APPEAL

CROSS APPEAL NO. 91-1796 CASE NUMBER

CIRCUIT 5 APPEAL ___ FROM Northern DISTRICT OF Texas AT Dallas

DATE DOCKETED 7/31/91 $100 FEE PAID Pd DC
JUDGE Barefoot Sanders

DATE NOTICE OF APPEAL FILED 7/24/91

D.C. DOCKET NUMBER CA3-91-0753-H
REPORTER _____

IN THE MATTER OF: LEONARD NOBLEMAN and HARRIET NOBLEMAN,

Debtors.

LEONARD NOBLEMAN and HARRIET NOBLEMAN,

Appellants,

versus

AMERICAN SAVINGS BANK and TIM TRUMAN, Standing Chapter 13 Trustee,

Appellees.

APPEARANCE FILED DATE	CODE	ATTORNEYS FOR APPELLANT	ARG
		FOR: LEONARD & HARRIETT NOBLEMAN	
8-12-91	✓	Philip Palmer, Jr., One Main Pl, 1201 Main St., Ste. 1510, Dallas, TX 75202 (214/748-1211)	✓

~~8-12-91~~	*	~~Rosemary J. Zyne~~ ~~Three Lincoln Centre,~~ ~~LB 33,~~ ~~5430 LBJ Frwy., Ste. 875~~ ~~Dallas, TX 75240~~ ~~(214/960-7477)~~	
mft		FOR AMICUS CURIAE HAROLD J. BARKLEY:	
10-28-91	✓	Terre M. Vardaman, P.O. Box 55849, Jackson, MS 39296-5849 (601) 981-7800 3218 N. State St. (39216)	

APPEARANCE FILED DATE	CODE	ATTORNEYS FOR APPELLEE	ARG
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9-9-91	✓	Michael J. Schroeder, -do-	✓
9-9-91	x	David M. Odens, -do- Comerica Bank Bldg., 4131 N. CentralExpwy., Ste. 1000 Dallas, TX 75201 (214/520-3300)	

		FOR TIM TRUMAN:	
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		Ste. 510,	✓
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		Loan Mortgage Corp.)	
12-6-91	✓	Dean Cooper, Assoc.	
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		Branch Dr.,	
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		(703) 903-2641	
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		Mortgage Bankers Assn. of	
		America)	
12-6-91	✓	Michael L. Riddle,	
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		York Tower	
		1999 Bryan St.,	
		Dallas, TX 75201	
		(214) 220-6300	

1. RECORD, EXHIBITS AND BRIEF INFORMATION
Filing:

Reporter's Ack. due _____ Trans. Fld. _____

Transcript due _____ Disc. Date _____

_____ Partial Record or Cert. List

8-12-91 Record on Appeal No. of Vols. 2

_____ Supp. Record No. of Vols. ___

_____ Second Supp. Record No. of Vols. ___

_____ Third Supp. Record No. of Vols. ___

_____ Exhibits ___ Env. ___ Box ___ Pkg. ___ Roll

_____ Exhibits ___ Env. ___ Box ___ Pkg. ___ Roll

_____ Appendix ___ (P) ___ (M)

SEP 25 1991 Records Excerpts - Appellant

_____ Record Excerpts - Appellee

_____ Briefing Notice Issd. _____

SEP 25 1991 Brief for Appellant (27) _____

_____ Brief for Appellant _____

_____ Brief for Cr. Appellant _____

10-31-91 Brief for Appellee (22) Amer. Sugs. Bank

11-15-91 Brief for Appellee (27) Truman

_____ Brief for Appellee _____

_____ Brief for Cr. Appellee _____

12-9-91 Reply Brief for Appellant (17) _____

_____ Reply Brief for Cr. Appellant _____

_____ Supp. Brief for Appellant _____

_____ Supp. Brief for Appellee _____

OCT 15 1991 Brief for Amicus (9) Barkley _____

_____ Intervenor _____

5/11/92 Rule 28(j) letter – Appellant (j) _____

1/31/92 Rule 28(j) letter – Appellee (j) (Appelle American Savings)

11-22-91 Brief for Amicus (20) Fed. Hm. Ln.

4-22-91 Brief for Amicus (9) Murt. Bankers

7/27/92 Rule 28(j) ltr. – appellant(J)

MISCELLANEOUS FILINGS Filing:

7/31/91 Dup. Notice of Appeal and Clerk's Statement of Docket Entries

_____ Papers Trans. from Misc. No. _____

_____ Order of DC Granting/Denying Appeal IFP

_____ Order of DC Granting/Denying IFP & CPC

_____ Order of DC Appointing Counsel

_____ Affidavit of Financial Status

_____ CJA 20 Issd./Voucher Recd. _____

_____ NOA Treated as CPC Application

AGENCY REVIEW CASES Filing:

_____ Petition for Review of Order ( ) of
__ NLRB __ FERC __ ICC __

_____ Application for Enforcement – NLRB

_____ Answer to Application for Enforcement

_____ Cross Application for Enforcement

4. EXTENSION Flg. Motion for: Order Fld. Ext. to:

_____ Transcript _____

_____ Transcript _____

_____ Transcript _____

_____ Appellant's Brief _____

_____ Appellant's Brief _____

_____ Appellant's Brief _____

_____ _____

_____ Appellee's Brief _____

_____ Appellee's Brief _____

_____ Appellee's Brief _____

_____ Reply Brief _____

_____ _____

_____ _____

5. CALENDAR INFORMATION Week of 3-9-92

Special Panel _____

Summary Panel: _____

1-31-92 Case Assigned for 3-11-92 in
✓EB _W _E _ _____

_____ Case Cont'd for Reassignment _____

_____ Case Reassigned for _____ in
_EB _W ✓E _ _____

Hearing Panel: JRB, WG, EMG

3/11/92 Case Argued ✓ by Appellant
✓ by Appellee _____

_____ Case Sub. w/o Arg. _ by Appellant
_ by Appellee

6. OPINION INFORMATION P ✓ NP _ 7 Print Pages

08/13/92 Opinion Rendered

EMG Affirmed ____ _____

____ Reversed _____

____ Affd. in Pt. ____ P.C. ____ Conc. Spec.

____ Vacated XX Signed ____ Dis.

____ Dismissed ____ Rule 47.6 ____ Dis. in Pt.

_____ Opinion Withdrawn _____

_____

7. REHEARING INFORMATION

_____ Mot. for Ext. - Ext. to: _____

_____ Mot. for Ext. - Ext. to: _____

_____ Petition for Rehearing _____
___ Appellant ___ Appellee ___ Reg.
___ En Banc

_____ Petition for Rehearing _____
___ Appellant ___ Appellee ___ Reg.
___ En Banc

_____ Response of _____

_____ Order Denying Rehearing
___ Dissenting

_____ ___ Opinion Petition for Rehearing

_____

NO. 91-1796

8. MOTIONS

Filing Motion to or for:	Response Filed By	Date Granted	Denied	Court Clerk By	Date
Mandamus					
Reinstate Appeal					
Stay Further Proceedings in CA					
Stay Pending Appeal					
Injunction Pending Appeal					
Consolidate Appeals W/					
Leave to Appeal IFP					
Bail Pending Appeal					
Withdraws as Counsel					
Appointment of Counsel					
Supplement Record					
Expedite					
File Brief in Excess Pgs.					
File Brief in Excess Pgs.					
Dismiss by Appellant					
Dismiss by Appellee					
10/7/91 Amicus Curiae (Barkley)				✓	10/15/91
File Supp. Brief					
Stay of Mandate					
Recall of Mandate					
Intervene					
Intervene					
File Reply Br. out of time				✓	

9. OTHER DOCKET ENTRIES

9/23/91	Flg. Ltr dtd. 9/18/91 from counsel for appellant consenting to filing of amicus curiae brief by Harold J. Barkley, Jr., Chapter 13 Trustee.
11/12/91	Flg. Mot. of Mortgage Bankers Assn. of America for leave to file amicus brief in support of appellee American Savings Bank, F.A.
11/14/91	Flg. Mot. of Federal Home Loan Mortgage Corp. for leave to file amicus brief in support of appellee American Savings Bank, F.A.
11/22/91	Minute Entry – Motion of Federal Home Loan Mortgage Corp. for leave to file amicus curiae brief in support of appellee is GRANTED.
11/22/91	Minute Entry – Motion of Mortgage Bankers Assn. of America for leave to file amicus curiae brief in support of appellee is GRANTED.

10. JUDGMENT OR MANDATE INFORMATION

_____	Bill of Costs
AUG 13 1992	Flg. & Entg. Judgment
_____	Issg. Copy of Jdgt. to Bd & Cnsl. Mandate Stayed to _____
SEP 4 1992	Jdgt. as Mdt. Issd. to Clerk
_____	Jdgt. as Mdt. Reissd. to Clerk
_____	Dismissal Issd. to Clerk _____
SEP 8 1992	Record on Appeal Retd. to Clerk 2 vols.
_____	Exhibits Retd. to Clerk
_____	_____
_____	_____

11. SUPREME COURT INFORMATION

_____	Notice of Appeal to S.C.
12-17-92	Preparing Proceedings on Certiorari (1 Vol.)
_____	Preparing Supp. Proceedings on Cert.
_____	Transmitting Orig. Exhibits to S.C.
_____	Order of S.C. – Ext. to _____
10/20/92	Notice of Flg. of Cert. Pet. on 10/13/92
12-14-92	Order of S.C. ___ Denied X Granted 12-7-92
_____	Notice of Denial of Pet. for Rehearing
_____	Opinion of S.C. dated _____

S.C. Docket # 92-641

S.C. Subj. Matter ___ Crim ___ USC ___ P. Civ. ___ AGCY

_____

Supreme Court, U.S.
FILED
JAN 21 1993
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No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF ON THE MERITS FOR PETITIONERS, LEONARD NOBELMAN AND HARRIET NOBELMAN

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QUESTION PRESENTED FOR REVIEW

May debtors in a Chapter 13 bankruptcy case use 11 U.S.C. Section 506(a) to reduce the secured claim upon their residence to fair market value and treat the balance as an unsecured claim without violation of 11 U.S.C. Section 1322(b)(2)?

LIST OF ALL PARTIES TO THE PROCEEDING IN THE COURT WHOSE JUDGMENT IS SOUGHT TO BE REVIEWED

Leonard Nobelman and wife, Harriet Nobelman -

Debtors and Appellants

American Savings Bank -

Creditor and Appellee

Molly W. Bartholow (then Tim N. Truman) -

Standing Chapter 13 Trustee

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In re Nobelman, 129 B. R. 98 (N.D. Tex. 1991) (Pet. Cert. App. 16-31)

In re Nobelman, Case No. 390-35116-HCA-13 (Bankr. N.D. Tex. 1991) (Pet. Cert. App. 32-35)

STATEMENT OF THE GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED AND TIME FACTORS

Petition for Certiorari was filed on October 13, 1992, from the Judgment of the Court of Appeals, which was entered on August 13, 1992, giving jurisdiction under 28 U.S.C. Section 1254.

STATUTES WHICH THE CASE INVOLVES

Title 11, U.S.C. Section 103(a)

"Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title."

Title 11, U.S.C. Section 506(a)

"An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may

be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."

Title 11, U.S.C. Section 1322(b)(2)

"(a) The plan shall –

(1) provide for the submission of all or such portion of future earnings of other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim; and

(3) if the plan classifies claims, provide the same treatment for each claim within a particular class.

(b) Subject to subsections (a) and (c) of this section, the plan may –

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with

the debtor differently than other unsecured claims,

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) provide for the payment of all or any part of any claim allowed under section 1305 of this title;

(7) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(8) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity; and

(10) include any other appropriate provision not inconsistent with this title.

(c) The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years."

STATEMENT OF THE FACTS OF THE CASE

The Nobelmans' residence is a condominium with a fair market value of $23,500, although secured by a lien in the total amount of $71,335.04. In their Chapter 13 Plan of Debt Adjustment, the Nobelmans proposed to value down the secured claim to the fair market value and treat the balance as an unsecured claim under a technique commonly called "lien splitting." (From Bankruptcy Judge's Findings of Fact and Conclusions of Law, Pet. Cert. App. 32-34.)

SUMMARY OF ARGUMENT

When the mortgage exceeds the value, all debtors have the right in all chapters of bankruptcy to abandon their homestead. The lienholder, having foreclosed, may file an unsecured claim for its deficiency, which, as unsecured, will be subject to discharge.

All 11 U.S.C. Section 1322(b)(2) does is to replicate the effect of that foreclosure in Chapter 13 proceedings, giving the creditor a secured claim to the fair market value which it would have received at foreclosure, with an unsecured claim for its anticipated deficiency. This result is dictated both by the plain language of Section 1322(b)(2) and construction of the Bankruptcy Code (adopting the common name, although technically the Bankruptcy Reform Act of 1978) as a whole. Chapters 1, 3, and 5 apply generally to Chapters 7, 11, 12, and 13. The meaning of Section 1322(b)(2) is very clear if one has first read Section 506(a) to ascertain the definition of secured claim.

The legislative history of the homestead lien restriction in Section 1322(b)(2) shows that it is a compromise between the House of Representatives and the Senate, but gives no further guidance to the issue before this Court. Four Circuits in six decisions support the position of the Petitioners, while the opinion being reviewed disagrees.

ARGUMENT

(a) Question Presented and Practical Aspects

If all good things must come to an end, as is often said, then it was only to be expected that the go-go years would end in the real estate collapse of the mid-eighties. With the glut of real estate now in lender and federal hands, it is difficult to predict either the nadir or the duration. There are a great many unfortunates who now are saddled with high mortgage amounts and high interest rates that had their genesis in another economic time,

but which are both onerous and unrealistic today. As these unfortunates come to the point of financial disaster sufficient to compel the filing of a Title 11 proceeding, their first wish is usually to save their homestead if they can, since they are ill-equipped to acquire another. Certainly they can always rent, and rental rates reflect the true economic times, but how far did Congress intend to go in providing them an alternative to salvage their home? That is the question posed by this case.

Certainly, these Debtors have the right to abandon the homestead, an issue upon which there is no dispute. Assuming a situation of no equity, as here, it would then be anticipated that the lienholder would obtain permission from the Court to foreclose, by seeking a lift of the stay. At the foreclosure sale, the assumption continues that the lienholder will receive something approximating the fair market value, with the balance of its claim becoming an unsecured deficiency claim. That deficiency claim will be eligible to share *parri passu* with the other unsecured claims, but also will be discharged of any future liability against the Debtors.

If that option is always available to the Debtors, why not replicate the effect of a foreclosure in the bankruptcy itself? What would be inequitable in allowing as an alternative another option by which essentially the same result could be reached just by determining the fair market value at a valuation hearing, then having the secured claim reduced to that determined amount, and allowing the balance of the claim to be classified as unsecured? The Appellants Nobelman would assert that is exactly what 11 U.S.C. Section 506(a) was intended to do.

If that is so, however, how can it be reconciled with the apparent special protection which 11 U.S.C. Section 1322(b)(2) grants to the holders of a homestead lien? Would it not be so, just as Appellees have complained, that a homestead lien would then be treated as just another secured claim?

The response is, not really. Certainly, 11 U.S.C. Section 1322(b)(2) does bestow special protection for a homestead lien, but it does not follow that the lien is completely untouchable. The question is better stated, just how much special protection did Congress intend to provide? It is undisputed that no special protection exists in the Bankruptcy Code for any lien other than an exclusive homestead lien. Thus, for liens secured by vehicles, furniture, other real estate, or even the homestead, if in combination with anything else, the debtors can reduce the lien to fair market value, as well as change the interest rate, stretch out payments, and alter the terms. This cannot be done as to an exclusive homestead lien. The original contract terms must be met as to interest rates, payment amounts, and contract terms (as the Nobelmans have done in this case). These restrictions, the Appellants assert, are the special protections, and the only special protections afforded by Congress to the homestead lienholder.

If, however, the impoverished debtors are to have their feet held to the fire anyway, at least as to the same monthly payment amounts, what is the real benefit to them of a reduced amount in principal? There are two benefits, in fact. The first is the light at the end of the tunnel. That can be easily illustrated by the facts of this case alone. If the Nobelmans were forced to pay

$71,335.04 (which, with interest, would be over $100,000) to keep a homestead worth $23,500, they will necessarily be paying much more than the value of the asset serving as collateral. That is money which cannot go to unsecured creditors or family expenses. The dollars available to the Nobelmans are finite in number and can only be spent once.

The second benefit is that it makes refinancing of the homestead mortgage a viable option for the first time. The benefit to the new lienholder is that it allows to it a competitive return on current market rates with collateral actually worth the amount of the debt. The benefit to the debtor is that if refinanced, they now can have the benefit of interest and payment amounts reduced to realistic amounts.

The benefits are even greater for the old lienholder, because it will receive cash equal to the fair market value of its collateral. Too often in the real world when the old lienholder is required to foreclose, it will exercise its right to credit bid and become the new owner. Indeed, it frequently will be the only bidder to appear at the foreclosure sale. The result, of course, is more real estate to go into its inventory. The bank graveyard is now littered with institutions who became top heavy with real estate in inventory, and then watched continued write-downs by examiners until the point of insolvency was reached. Bank examiners also live in the real world and are unfettered by 11 U.S.C. Section 1322(b)(2).

Wouldn't the result often be, however, a windfall to debtors as the real estate market recovers? The truthful answer is maybe, depending on just when and if the real

estate market recovers and how great that recovery may be. On any given day, the market forces are such that fair market value could rise or sink even further. Those prospects are taken into consideration in any appraisal. The Bankruptcy Code requires that a fair market value be determined at some precise time in a number of areas, ranging from adequate protection to confirmation in Chapter 11 Reorganizations. That determination is made in an evidentiary hearing with all parties-in-interest entitled to present all of the factors relevant to value, including the prospect of a future rise in price. Federal Rule of Bankruptcy Procedure 3012. Application of this rule works well for commercial real estate and there is no reason why it cannot work equally well for residential property.

(b) Language of Statute

One must assume that these and other practical aspects were all considered by Congress in the enactment of Sections 1322(b)(2) and 506(a). As this Court has said, the inquiry here is to ascertain and apply Congressional intent. *Sinclair Refining Co. v. Atkinson*, 370 U.S. 195 (1962); *U.S. v. American Trucking Assoc.*, 310 U.S. 534 (1940). It is not to sit as a legislative committee to hear policy complaints.

It is the plain language which controls, *Patterson v. Shumate*, ___ U.S. ___, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992); *United States v. Nordic Village, Inc.*, ___ U.S. ___, 112 S. Ct. 1011, 117 L. Ed. 2d 181 (1992); *Union Bank v. Wolas*, ___ U.S. ___, 112 S. Ct. 527, 116 L. Ed. 2d 514 (1991); *Board of Governors. v. McCorp. Financial, Inc.*, ___ U.S. ___, 112 S.

Ct. 459, 116 L. Ed. 2d 358 (1991). The presumption is that Congress says what it means and means what it says. *Connecticut Nat. Bank v. Germain*, ___ U.S. ___, 112 S. Ct. 1146, 117 L. Ed. 2d 391 (1992).

In the format of the Bankruptcy Code, Chapters 1, 3, and 5 are of general application throughout the Code, while Sections 7, 11, 12, and 13 set out the specific relief chapters. 11 U.S.C. Section 103.

The Bankruptcy Code should be construed as a whole. *Dole v. United States*, 494 U.S. 76 (1990); *In re Timbers of Inwood Forest*, 793 F.2d 1380 (5th Cir. 1986), vacated 802 F.2d 777 (5th Cir. 1986), reinstated on rehearing en banc, 866 F.2d 363 (5th Cir. 1987), aff'd, *United Savings Association v. Timbers of Inwood Forest Association*, 481 U.S. 1068 (1987); 2 A *Sutherland, Statutory Construction* (4th ed.), Section 46.05. It is almost always unsafe to divide a statute when considering it. *Richards v. United States*, 369 U.S. 1 (1962); *see also, United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989) (the lack of a detailed legislative history is not disastrous when the meaning is plain and the statutory scheme is both coherent and consistent).

The answer to the question before the Court permits a simple conclusion if, but only if, one first reads 11 U.S.C. Section 506(a) and accepts that secured claim means collateral value. The total claim may be partially unsecured if the collateral value is less than the claim. In common parlance, one may speak of a $50,000 secured claim on a $1,000 automobile, but in the bankruptcy context, it becomes necessary to re-orient the thinking to a $1,000 secured claim and a $49,000 unsecured claim.

Thus, when one reads 11 U.S.C. Section 1322(b)(2) with the 11 U.S.C. Section 506(a) definition of secured claim in mind, the terms "secured claims," "claims secured," and "security interest" are all read as if the additional words "to the extent of collateral value" appeared immediately after each such phrase. That mental insertion is what 11 U.S.C. Section 506(a) commands, and when the command is followed, the confusion and ambiguity found by some courts, including the panel below, disappear.

While many other authorities have reached contrary results, they all have indulged in backward reasoning. That is to say, instead of first examining the Code sections of general application before going to the specific chapter, they begin at 11 U.S.C. Section 1322(b)(2) and make their initial determination of just what the homestead lien restriction is. Only then do they turn back to 11 U.S.C. Section 506(a). When 11 U.S.C. Section 506(a) does not seem to support the initial conclusion reached, they decide that there is a conflict between the two statutes which must be resolved. One technique which was used by the panel below is to decide that while 11 U.S.C. Section 506(a) may reduce "secured claim" to collateral value, the "rights" of holders of secured claims remain as before, a $50,000 lien on a $1,000 vehicle. Thus, the Section 1322(b)(2) exclusion is to the "rights" of a homestead lien, and these "rights" are unaffected by 11 U.S.C. Section 506(a). *See In re Etching*, 128 B.R. 662 (Bankr. W.D. Wisc. 1991), applying what it terms the "rule of last antecedent." The flaw in the reasoning of these grammatical gymnastics is that when Congress reduces the secured claim to collateral value, it has also reduced the

rights of the holder of such a secured claim. Thus, when 11 U.S.C. Section 506(a) reduces secured claims, inescapably it has reduced the rights of the holders of secured claims as well.

The recent case of *Lomas Mortgage USA v. Wiese*, ___ F.2d ___ (1992 WL 354915) (9th Cir. 1992), examined and rejected the *Etching* type argument, holding that the "other than" clause clearly modified "secured claim."

By far the more common approach is simply to read 11 U.S.C. Section 506(a) out of the Code, at least where 11 U.S.C. Section 1322(b)(2) is concerned. This is done by declaring that 11 U.S.C. Section 1322(b)(2) is a specific statute, while 11 U.S.C. Section 506(a) is general in nature. Since they are perceived to conflict, 11 U.S.C. Section 1322(b)(2) is held to modify the general. That technique was also employed by the panel below.

This approach has unquestioned validity when applied in such a fashion as to read a limited repeal into an older statute of wide scope when considering its effect upon a newer and more specific enactment with which it appears to conflict. It is a bit more unusual to see it applied as to two sections of the same enactment. The more common approach is to see if the entire enactment cannot be read harmoniously without leading to absurd results. Of course, Chapters 1, 3, and 5 are general. They are intended to be, since they are of general application in Chapters 7, 11, 12, and 13. If the general/specific dichotomy is to be approved by this Court, then any time a Chapter 1, 3, or 5 section is found at odds with a perceived result, it can be disregarded, a result surely at odds with the intent of Congress.

(c) Legislative History

Those opposed to 11 U.S.C. Section 506(a) contend there is clear support to their position in the legislative history. The Nobelmans, frankly, find only some support for special protection to the holders of homestead mortgages, but no help whatsoever to answer the question of how far that protection was intended to go. Still, recent opinions of this Court indicate that while the first examination should be of the language itself, there may still be a look at the history. *Toibb v. Radloff*, ___ U.S. ___, 111 S. Ct. 2197, 115 L. Ed. 2d 145 (1991); *Johnson v. Home State Bank*, ___ U.S. ___, 111 S. Ct. 2150, 115 L. Ed. 2d 66 (1991); *Farrey v. Sunderfoot*, ___ U.S. ___, 111 S. Ct. 1825, 114 L. Ed. 2d 337 (1991).

Intellectually, we must acknowledge at the outset that a search for the intent of Congress is something of a fiction, in that the chance of hundreds of men having exactly the same intent is infinitesimally small. *Rodin, Statutory Interpretation*, 43 *Harv. L. Rev.* 863, 869 (1930). Nevertheless, there are certain time-honored rules of construction and extrinsic aids to guide the search.

Reports of standing committees are generally regarded as a reliable source for learning the meaning of the bill in issue. 2A *Sutherland, Statutory Construction* (4th ed.), Section 48.06. Statements of the committeeman in charge of the bill are accorded the same degree of reliability. 2A *Sutherland, Statutory Construction*, (4th ed.), Section 48.14.

The Bankruptcy Code, which emerged on October 6, 1978, had been in process for over five years. It was a conglomeration of ideas and compromises from

numerous sources, many of whom were not Congressmen. The best and most exhaustive collection of materials on the legislative history is found in three volumes of *Collier on Bankruptcy*, (15th ed.), Appendix Volumes 1-3. Included there is an article by Kenneth Klee, which amounts to a roadmap of the activities leading up to the enactment, *Legislative History of the New Bankruptcy Law*, originally appearing in 28 *DePaul L. Rev.*, 941 (1979). With specific reference to 11 U.S.C. Sections 506(a) and 1322(b)(2), see also 3 *Collier on Bankruptcy*, (15th ed.), Section 506.03; *Howard, Stripping Down Liens: Section 506(d) and the Theory of Bankruptcy*, 65 *Am. Bankr. L. J.*, 373 (1991).

The Commission on the bankruptcy laws of the United States (which included four Congressmen out of nine members) submitted both its report and the first draft of the new bankruptcy law in 1973. *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Dec. No. 93-137, 93rd Cong., 1st Sess., Part II, 204 (1973). The Commission Report spoke in favor of reducing homestead liens to value, but the Code draft attached as Exhibit II contained no language carrying that out. This inconsistency lends credence to the report that the Code draft itself was written by the National Bankruptcy Conference, a private group. In 1974, a competing draft was prepared by the National Conference of Bankruptcy Judges.

Both the Commission bill and the Judges' bill, as they came to be commonly called, were introduced by the 93rd Congress and then re-introduced to the 94th Congress.

These drafts were circulated to bench, bar, and academicians for comment. At the particular urging of Representative Don Edwards, the National Bankruptcy Conference and the National Association of Bankruptcy Judges conferred and were able to resolve many, but not all, of the differences in the two drafts. These compromises permitted the introduction on July 11, 1977, by the House Judiciary Committee, of a single bill, H.R. 8200, in the place of the former Commission and Judges' bills. To this point, there is no exclusion as to homestead liens similar to 11 U.S.C. Section 1322(b)(2) found in H.R. 8200, or in the earlier Commission or Judges' bills.

For most of this period, there was little activity in the Senate. Nothing comparable to H.R. 8200 had been introduced. It is true that some two years earlier, specifically from February to November of 1975, the Senate Subcommittee on Improvements in Judicial Machinery held hearings, during which nearly 80 witnesses testified over 24 days, while another several hundred interested parties presented their views in writing. *Senate Debates*, 124 Cong. Rec. S14718-45 (*Daily Ed.*, September 7, 1978).

One of the 80 witnesses who appeared was a Mr. Edward J. Kulik, a Senior Vice President of Massachusetts Mutual Life Insurance Company. He was opposed to any reduction in homestead liens and much preferred that all homeowners be forced to pay in full. It is to this position statement that most look for to support a view that the legislative history shows an intent to favor homestead liens by excluding the application of 11 U.S.C. Section 506(a). *See, Grubbs v. Houston First American Savings Ass'n.*, 730 F.2d 236 (5th Cir. 1984, en banc).

Statements by interested witnesses are not even admissible to determine legislative intent. 2A *Sutherland, Statutory Construction*, Section 48.16. Regrettably, the Senate Subcommittee never made a report as to its conclusions, so we have no clue as to how it may have evaluated the hundreds of position statements that it considered.

That was essentially the total activity of the Senate until Senator DeConcini was appointed as Chairman of that Subcommittee almost two years later. He then introduced S. 2266 as the Senate version of H.R. 8200 on October 31, 1977. The relevant part of S. 2266 then read that a Chapter 13 debtor may "modify the rights of holders of secured claims (other than claims secured by mortgages on real property)." Then, as now, there was no language to indicate that the 11 U.S.C. Section 506(a) definition of secured claim was or was not meant to be first applied.

S. 2266 was accompanied by the report of the Senate Committee of the Judiciary, which includes the Subcommittee for Improvements in Judicial Machinery. The report, however, only repeats the statutory language, again giving no further insight.

On September 7, 1978, the Senate considered H.R. 8200, but substituted its S. 2266, and then requested a conference with the House. While formal conferees were named by each chamber, it was concluded that time was too short for formal conferences. If agreement could not be reached on a single bill by October 14, 1978, the 95th Congress would adjourn and the process would have to begin anew in the 96th Congress. Consequently, it was

decided it would be necessary to forego any formal meetings and to seek resolution by informal, and unreported, meetings.

The burning issues of the day did not deal with homestead liens. That concern was overshadowed by disagreements about the method of appointment and the status of Bankruptcy Judges, or the creation and funding of a United States Trustee system. All of these differences and more were resolved by a series of unreported compromises. *See, Matter of Pierce*, 935 F.2d 709, 713 (5th Cir. 1991).

We know that there was also a compromise on the 11 U.S.C. Section 1322(b)(2) issue, but only because the language of H.R. 8200 and S. 2266 was re-written as it appears now. There is nothing, however, to tell us that the compromise extended to excluding 11 U.S.C. Section 506(a).

(d) Review of Decisions

When the Ninth Circuit was first presented with the exact question as here, it found the question not that difficult of resolution. It reasoned that 11 U.S.C. Section 103(a) made 11 U.S.C. Section 506(a) applicable to 11 U.S.C. Section 1322(b)(2). Consequently, only the secured portion of a homestead mortgage debt was protected. Moreover, this analysis presented no conflict, so that normal principles of statutory construction were sufficient to answer the question. *In re Houghland*, 886 F.2d 1186 (9th Cir. 1989).

The Third Circuit agreed, concluding that Section 506(a) limited the secured claim to fair market value, so that was the only portion of the claim which could not be modified under Section 1322(b)(2). The rest of the claim was unsecured, and thus, was eligible for modification under the Plan along with other unsecured claims. *Sapos v. Prov. Inst. of Savings*, 967 F.2d 918 (3rd Cir. 1992); *Wilson v. Commonwealth Mortgage Bank*, 895 F.2d 123 (3rd Cir. 1990).

The Tenth Circuit also concurred, reasoning that Section 506(a) creates two claims, one secured and one unsecured. 11 U.S.C. Section 1322(b)(2) provides special protection only to the secured claim. *In re Hart*, 923 F.2d 1410 (10th Cir. 1991).

The Second Circuit also joined with the majority in *Bellamy v. Federal Home Loan Mortgage Co.*, 962 F.2d 176 (2nd Cir. 1992). At the same time, it concluded that this result was not affected by *Dewsnup v. Timm*, ___ U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), since that decision involved non-residence farmland previously abandoned from the estate by the Chapter 7 Trustee. *Dewsnup* further construed Section 506(d) instead of Section 506(a) and also stated that it would be limited to its facts. The Third Circuit has subsequently agreed. *Lomas Mortgage USA v. Wiese*, ___ F.2d ___ (1992 WL 354917) (9th Cir. 1992).

CONCLUSION

Petitioners pray that the opinion of the Court of Appeals for the Fifth Circuit be reversed and rendered, with this matter to be remanded to the Bankruptcy Judge for the Northern District of Texas to reconsider confirmation of the Nobelmans' Plan of Debt Adjustment consistent with this Court's opinion.

Respectfully submitted,

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No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK, F.A.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF ON THE MERITS OF RESPONDENT AMERICAN SAVINGS BANK, F.A.

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QUESTION PRESENTED FOR REVIEW

Does 11 U.S.C. § 1322(b)(2) (1988) prohibit a debtor from bifurcating a secured claim, secured only by a security interest in real property that is the debtor's principal residence, into a secured portion equal to the value of the real property and an unsecured portion for the remainder of the indebtedness?

LIST OF ALL PARTIES TO THE PROCEEDING IN THE COURT WHOSE JUDGEMENT IS SOUGHT TO BE REVIEWED

Leonard Nobelman – Debtor and Petitioner

Harriet Nobelman – Debtor and Petitioner

American Savings Bank, F.A. – Creditor and Respondent

Murray Mortgage Company n/k/a STM Mortgage Company – Servicing Agent for Creditor and Respondent

Molly W. Bartholow (formerly Tim N. Truman) – Standing Chapter 13 Trustee

Charles L. Kennan, III – Attorney for Chapter 13 Trustee

Terre M. Vandaman – Attorney for Harold J. Barkley, Jr., Amicus Curiae

William E. Cumberland and Michael L. Riddle – Attorney for Mortgage Bankers Association of America, Amicus Curiae

Dean S. Cooper and Carla E. Craig – Attorney for Federal Loan Mortgage Corporation, Amicus Curiae

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In re Nobelman, Case No. 390-35116-HCA-13 (Bankr. N.D. Tex. 1991) (Pet. Cert., App. 32-35)

STATEMENT OF JURISDICTION

Petition for Certiorari was filed on October 13, 1992, from the Judgement of the Court of Appeals, which was entered on August 13, 1992, giving jurisdiction under 28 U.S.C. Section 1254.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS WHICH THE CASE INVOLVES

I. Amendment V to the Constitution of the United States of America:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor

shall private property be taken for public use, without just compensation.

II. 11 U.S.C. § 101(5) (1988):

(5) "claim" means –

(A) right to payment, whether or not such right is reduced to judgement, liquidated, fixed, continent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, dispute, undisputed, secured, or unsecured;

III. 11 U.S.C. § 506(a) (1988):

(a) An allowed claim of a creditor secured by a lien property in which the estate has interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

IV. 11 U.S.C. § 1322(b)(2), (5) (1988):

(b) Subject to subsections (a) and (c) of this section, the plan may –

(1) modify the rights of holders of secured claims, other than a claim secured only by security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(2) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

V. 11 U.S.C. § 1325(a)(5) (1988):

(a) Except as provided in subsection (b), the court shall confirm a plan if –

(5) with respect to each allowed secured claim provided for by the plan –

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder.

STATEMENT OF THE CASE

On June 21, 1984, Leonard and Harriet Nobelman (the "Debtors") executed a Note in the amount of $68,250.00 payable to American Savings Bank, N.A. ("American"), secured by a purchase money Deed of Trust on the primary residence of the Debtors. Murray Mortgage Company n/k/a STM Mortgage Company is the duly authorized servicing agent of American. (Petition for Cert., App. 32-33).

On August 6, 1990, the Debtors filed a voluntary petition for relief under Chapter 13 of United States Bankruptcy Code. On August 14, 1990, American filed its proof of claim for $71,265.04 which was later amended as a claim for $71,335.04. The Debtors filed their Chapter 13 Plan of Reorganization (the "Plan") on August 31, 1990, which was later modified. The Plan valued their residence at $23,500.00. The Debtors filed a Motion for Valuation along with the modifications to their Plan. At confirmation hearing, the Debtors offered the testimony of Leonard Nobelman, regarding the value of the property. No controverting evidence of the value was offered by any other party. (Petition for Cert., App. 32-33)

The Plan proposes to make direct payments to American at the mortgage contract rate only up to scheduled value of the collateral. The balance of American's claim ($41,257.66) is treated as a general unsecured claim under the Plan, payable *pari passu*. The unsecured creditors

receive nothing under the Chapter 13 Plan. Additionally, the Debtors propose to cure the prepetition arrearage owed to American through their Plan. Both American and the Standing Chapter 13 Trustee objected to confirmation. On the grounds that, *inter alia*, the Plan purports to alter the lienholder's rights as prohibited by 11 U.S.C. § 1322(b)(2) (1989 Supp.). (Petition for Cert., App. 32-33)

Accordingly, the Bankruptcy Court denied confirmation of the Nobelmans' modified Chapter 13 Plan as an impermissible modification of American's claim pursuant to the provisions of 11 U.S.C. § 1322(b)(2). On appeal, both the District Court and the Court of Appeals affirmed. (Petition for Cert., App. 1, 16, 32)

SUMMARY OF ARGUMENT

The Nobelmans in their Chapter 13 reorganization proceeding seek to bifurcate (*e.g.* "cram down" or "lien-split") the amount owing on their purchase money home mortgage loan into secured and unsecured portions, to repay the secured portion through their proposed plan of reorganization, and to discharge the unsecured portion under 11 U.S.C. § 1328 (1988). To achieve this result, they invoke 11 U.S.C. § 506(a) (1988), which provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of . . . such creditor's interest in the estate's interest in such property" and is an unsecured claim as to the remainder.

The Bankruptcy Court, the District Court and the Fifth Circuit Court of Appeals rejected this argument,

concluding that application of § 506(a) in the context of Chapter 13 reorganizations would impermissible modify the claim of American secured by the Nobelmans' principal residence, in violation of 11 U.S.C. § 1322(b)(2) (1988). That section specifically provides that the *rights* of a holder of "a claim secured only by a security interest in real property that is the debtor's principal residence" may *not* be modified as a part of Chapter 13 reorganization.

The lower court's decision should be affirmed because a natural reading of the plain statutory language of Section 1322(b)(2) demonstrates that a claim held by a home mortgage lender may *not* be bifurcated. Moreover, the structure of the Bankruptcy Code is such that § 506(a) is *not* self-executing and does *not* automatically turn the claim of a residential mortgage lender into secured and unsecured portions. Further, bifurcating a residential mortgage debt is inconsistent with the overall scheme of the Bankruptcy Code because it provides a windfall to Chapter 13 debtors without furthering its "fresh start" objective. In short, the Nobelmans' interpretation of § 1322(b) drains the statute of meaning and contravenes public policy which abhors the results of bifurcation upon the home mortgage industry and the home buying public.

The reasoning supporting the lower court's order is also founded upon a proper review of the legislative history of 11 U.S.C. § 1322(b) (1988) as set forth in *Grubbs v. Houston First American Savings Association*, 730 F.2d 236 (5th Cir. 1984). That Court, facing the question of whether a Chapter 13 Plan could cure a default on a residential loan, reviewed the legislative process and history and

concluded that Congress intended to permit a cure of defaults under 11 U.S.C. § 1322(b) (1988), but *not* modifications of the underlying residential loan indebtedness. Congress' history is clear that bifurcation is *not* to be allowed as against residential mortgage lenders. Accordingly, the opinion of the Fifth Circuit should be affirmed.

ARGUMENT

I.

THE PLAIN LANGUAGE OF § 1322(b)(2) PROHIBITS A DEBTOR FROM BIFURCATING A CLAIM, SECURED ONLY BY A SECURITY INTEREST IN REAL PROPERTY THAT IS THE DEBTOR'S PRINCIPAL RESIDENCE, INTO A SECURED PORTION EQUAL TO THE VALUE OF THE REAL PROPERTY AND AN UNSECURED PORTION FOR THE REMAINDER OF THE INDEBTEDNESS.

A complete and proper determination of the question presented for review in this case begins and ends with the plain language of § 1322(b)(2). *See Patterson v. Shumate*, 504 U.S.___, 112 S. Ct. 2242, 2245 (1992); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, ___, 109 S. Ct. 1026, 1030 (1989). "In determining the meaning of any statute, the words of the statute are 'the primary, and ordinarily the most reliable, source of interpreting its meaning.' " *In re Chavez*, 117 B.R. 733, 735 (Bankr. S.D. Fla. 1990) (quoting *Watt v. Alaska*, 451 U.S. 259, 266, n. 9, 101 S. Ct. 1673, 1678, n. 9 (1981)). "[W]here the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.' " *Ron Pair*, 109 S. Ct. at

1030 (quoting *Caminetti v. United States* 242 U.S. 470, 485, 37 S. Ct. 192, 194 (1917)).

This Court has recently looked to the plain language and natural reading of statutory provisions, *Patterson v. Shumate*, 112 S. Ct. at 2242; that "a legislature . . . means in a statute what it says . . . " *Connecticut National Bank v. Germain*, 503 U.S. ___, 112 S. Ct. 1146, 1149 (1992); and that courts must give effect to the plain meaning of a statute. *Union Bank v. Wolas*, 502 U.S. ___, 112 S. Ct. 527, 531 (1992). In fact, in the *Ron Pair* decision, this Court analyzed the effect of § 506(b) with regard to the question of an over secured creditor's right to postpetition interest by looking first to the natural reading of the statute and then to the statute's grammatical structure. 109 S. Ct. at 1030. An application of the *Ron Pair* methodology to § 1322(b)(2) mandates the result afforded by the *Nobelman* courts below for the following reasons.

(a) "Rights" of Holders Defined

Section 1322(b)(2) contains three distinct phrases. It begins by giving a plan proponent an option – "the plan may. . . . " One of the options is the language at issue in this case – "modify the rights of holders of secured claims. . . . " Alternatively, a plan proponent may choose to "leave unaffected the rights of holders of any class of claims. . . . " Finally, the statute sets forth an exception to the choices of a debtor – "other than a claim secured only by a security interest in real property that is the debtor's principal residence. . . . " The structure of the statute is such that the "other than" exception phrase follows the first option – the right to modify.

Courts which approve of lien bifurcation under § 1322(b)(2) almost uniformly assume that the word "modify" refers to a creditor's "secured claim" (as that term is defined by § 506(a)). *See, e.g., In re Houghland*, 866 F.2d 1182, 1183 (9th Cir. 1989); *contra Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176, 179 (2d Cir. 1992). The Ninth Circuit, for example, points to 11 U.S.C. § 103(a) (1988) as making the general definitional provisions of § 506(a) applicable to Chapter 13 proceedings and automatically splits a creditor's claim into secured and unsecured portions. *Houghland*, 866 F.2d at 1183. Such rationalization ignores the plain language of the statute and the method of statutory interpretation taught by *Ron Pair*.

The plain language of the statute indicates that the grammatical object of the verb "modify" in the phrase preceding the first comma is the word "rights." *Nobelman v. American Savings Bank*, 968 F.2d 483, 485 (5th Cir. 1992); *In re: Etchin*, 128 B.R. 662, 666 (Bankr. W.D. Wis. 1991). Further, the term "secured claim" in this phrase is the object of the preposition "of." This prepositional phrase is an adjective which describes the type of "holders" being discussed in the statute. Thus, a clear and natural reading of the "modify" phrase of § 1322(b)(2) indicates that it is the *rights* of secured claim holders which *may* be modified. "Secured claims" in contrast is purely descriptive and in context, does not implicate an issue of valuation which calls for § 506(a) application.

The permissive "may" in the statute indicates what a plan can or cannot include. To interpret § 1322(b)(2) as itself effecting bifurcation is inconsistent with its structural purpose. Clearly, rights are to be modified in plans – not in the abstract. To hold that rights come into plans

already modified stands in the purpose of § 1322(b)(2) on its head.

At least one pro-bifurcation court has, however, correctly recognized the objective of the word "modify" as being the object of word "rights". *Bellamy*, 962 F.2d at 179. What the Second Circuit in *Bellamy* fails to recognize, in its decision, is what the word "rights" actually means in the context of § 1322(b)(2).

The Bankruptcy Code provides no definition of the word "rights." Many of these rights, however, have been judicially recognized. *See Dewsnup v. Timm*, 502 U.S.___, 112 S. Ct. 773, 777-79 (1992). A creditor who holds a debt secured by real property has the right to expect payment of the debt according to the terms of the debt instrument *Id.* Alternatively, upon default, the creditor has the right to proceed to foreclosure of the lien securing the debt. *Id.* These are basic rights.

Beyond these rights, however, such a creditor may have rights to demand preservation and non-waste of its collateral, to benefit from a borrower's credit life and disability insurance, to demand borrower occupancy of residential property in certain circumstances, to benefit from private mortgage, FHA or VA loan insurance, as well as other important rights. To define what "rights" are, requires a reference to non-bankruptcy law. *Cf. Barnhill v. Johnson*, 503 U.S. ___, 112 S. Ct. 1386, 1389 (1992) ("In the absence of any controlling federal law, 'property' and 'interest in property' are creatures of state law.").

The Second Circuit would have us view the definition of the term "rights" solely through the lens of § 506(a). *Bellamy*, 962 F.2d at 179. In that case, the court of

appeals ruled that bifurcation is permissible as against a residential real estate lender by posing the "real question" of "whether the 'rights' to which § 1322(b)(2) refers include the mortgagee's rights concerning its claim or its rights with respect to its secured claim." *Id.* The Second Circuit assumes incorrectly that the term "secured claim" fully defines the "rights" of such a holder. The *Bellamy* court rationalizes its decision by reference to the "cornerstone" of the Bankruptcy Code, namely that it effected a fundamental change from the Bankruptcy Act. *Id.* Such reasoning, however, completely ignores the plain language of the statute.

If Congress intended protection only for the secured portion of a creditor's home mortgage claim, then it would have written § 1322(b)(2) to read that a Chapter 13 plan may ". . . modify the rights of holders of *secured* claims . . . " This plainly is not the case. The term "rights," however, is not defined by the Bankruptcy Code to extend only to a residential lender's claim. The word "rights" must refer to the non-bankruptcy rights of a secured creditor. The valuation component of § 506(a) cannot, therefore, be automatically implemented in connection with § 1322(b)(2) merely because the latter statute includes the phrase "secured claim."

Given that the word "rights" includes a broader scope of elements than those listed by the Second Circuit, the next inquiry must be how are these rights affected by the anti-modification provision of § 1322 (b)(2). Such inquiry begins with a definition of the word "claim."

(b) "Claim" Defined

The plain language of § 1322(b)(2) *does not* limit its protection of residential mortgage lenders' claims to the component of such claims classified only as "secured" by § 506(a). Rather, § 1322(b)(2) prohibits modification of the rights of holders of *"a claim"* that is "secured by a security interest in real property that is the debtor's principal residence. . . . " Congress enacted the statute with a comma to separate the "modify" and the "other than" phrases of § 1322(b)(2) and, further, to maintain the independence of the latter phrase from the former. *In re: Etchin*, 128 B.R. at 668. The independence of the singular word "claim" is borne out by the statute's syntax and is subject to Bankruptcy Code definition. "Claim" is defined as the "right to payment, whether or not such right is . . . secured, or unsecured; or [the] right to an equitable remedy for breach of performance . . . whether or not such right . . . is . . . secured, or unsecured." 11 U.S.C. § 101(5)(A) (1988). Thus, the plain language of § 1322(b)(2) extends the anti-modification protection to residential mortgage lenders who hold *a claim*, without distinction as to whether that claim is "secured" or "unsecured."

The Second Circuit, in its opinion, rewrites the statute so that it would read that a plan may "modify the rights of holders of secured claims, other than [*rights related to the secured portion of*] a claim secured only by a security interest in real property that is the debtor's principal residence. . . . " *Bellamy*, 962 F.2d at 179. The statute does not, however, contain such additional language. It must be plainly read as it is written. A Chapter 13 plan may modify the rights of secured claim holders,

except ("other than") where a claim is one that is secured by solely residential real property. A natural reading of the statute, therefore, confirms that bifurcation is an impermissible modification as against the holder of a residential mortgage.

(c) Applicability of § 506(a)

The Nobelmans argue that § 506(a) defines "secured claims," pursuant to 11 U.S.C. § 103(a), for purposes of all cases under all chapters. Their reasoning follows that, when applied to § 1322(b)(2), § 506(a) *automatically* transforms the *claim* of American into secured and unsecured portions. The *Bellamy* court concurs in the position of the Nobelmans in this regard. 962 F.2d at 180-81. Applying the rule of last antecedent, the Second Circuit jumps to the conclusion that the "other than" clause must have as its subject the term "secured claim." *Id.* The *Bellamy* court ignores the fact that the modification phrase "other than" should be extended to the *entire* last antecedent, namely "the *rights* of holders of secured claims. . . . " *In re: Etchin*, 128 B.R. at 668. Such a plain reading of the statute extends the protection of anti-modification to the rights of holders of the defined type of claims. In addition, the Second Circuit fails to recognize that § 1322(b) is itself a definitional statute. The provisions of § 506(a) may be operational elsewhere within the Chapter 13 framework.

The plain reading of § 1322(b)(2) eliminates the self executing attribute accorded to § 506(a) by the pro-bifurcation courts, and at the same time allows § 506(a) to work its intended role in Chapter 13 proceedings (*e.g.*, to measure the value of secured claims under § 1325(a)(5)).

Pro-bifurcation courts mistakenly term § 506(a) as a cramdown statute. This is not the case. Section 506(a) is a mechanism to achieve property valuation. Once a valuation is accomplished, § 506(a) does *not* automatically kick in to bifurcate a secured creditor's claim. *See* Bankr. Rule 3012. *Accord Dewsnup*, 112 S. Ct. at 778. This mechanism *must* be applied to a *plan* in order to achieve such a result. The "rights" referred to in § 1322(b)(2) may be modified in a *plan*, *not* in the valuation mechanism of § 506(a). Further, application of § 506(a) to § 1322(b)(2) cannot, under the structure of the Bankruptcy Code, result in a bifurcation of *any* secured claims. Section 1322 tells us what a plan may do, what a plan may include. Section 1325(a), on the other hand, defines the standards for plan confirmation. Under § 1325(a)(5), absent creditor acceptance of a plan or Debtor's surrender of the secured property, a Chapter 13 plan will be confirmed only if:

> . . . the plan provides that the holder of such claim retain the lien securing such claim; and . . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim. . . .

A residential lender is, therefore, entitled – by virtue of the anti-modification provisions of § 1322(b)(2) – to lien retention and payment (distribution) of an amount that is "not less than the allowed amount of such claim. . . ." American's *allowed claim* is $71,335.04. (Petition for Cert., App. 33) Thus, since its *claim* cannot be modified, the Nobelmans' plan cannot be confirmed

unless such allowed claim is paid in full. *Accord Dewsnup*, 112 S. Ct. at 777.

Such a reading harmonizes the provisions of § 506(a) with those of § 1325(a)(5) to give effect to both, while at the same time preserving the anti-modification protection afforded to residential lenders in § 1322(b)(2). *Cf. United States v. Nordic Village Inc.*, 503 U.S.___, 112, S. Ct. 1011, 1014 (1992) (different statutory provisions should be read, where possible, as complimentary rather than in conflict with each other). In other words, a § 506(a) cramdown, liensplit or bifurcation may occur under § 1325(a)(5) with respect to secured creditors who do not benefit from the protection of § 1322(b)(2). A correct application of § 506(a) does not, therefore, condone the lien bifurcation sought by the Nobelmans.

(d) Alternatively – If a conflict exists

Alternatively, if a conflict is found to exist between § 506(a) and § 1322(b)(2), then the specific provision found in Chapter 13 *must* be accepted as controlling over the general provisions of Chapters 1, 3 and 5 which are applicable pursuant to § 103(a). *In re Schum*, 112 B.R. at 116. "This Court accepts the tenant of statutory construction that, regardless of the inclusiveness of the general language of a statute, it does not apply or prevail over matters specifically drafted within another part of the same enactment." *In re Chavez*, 117 B.R. at 744. Section 1322(b)(2) was specifically drafted to prevent modification of a claim secured *only* by a residential mortgage. As the District Court in *Nobelman* pointed out, a conflict exists between the two statutes to the extent "that

§ 506(a) may be used to undermine the protection afforded by § 1322(b)(2) under the very narrow circumstances defined by that statute." *In re Nobelman*, 129 B.R. 98, 102 (N.D. Tex. 1991). The "conflict" between § 506(a) and § 1322(b)(2), therefore, is controlled by the latter statute. As the Court in *In re Sauber*, 115 B.R. 197, 199 (Bankr. D. Minn. 1990), stated:

> [W]hat the *Houghland* Court did not seem to appreciate, is that we are dealing with general and specific concepts that are intended to apply and govern the rights of debtors and their creditors in different situations, and with different applications, depending upon particular Code purposes to be served. The application of general concepts is not universal in the scheme of the Code, but is subject to specific limitation, and even total disregard, in some instances.

Accord In re Boullion, 123 B.R. 550, 551 (the specific controls over the general). *See also In re Mahaner*, 34 B.R. 308, 309 (Bankr. W.D.N.Y. 1983) (§ 506(a) inapplicable where the statute would render a redemption provision of the Code "mere surplusage").

(e) Section 1322(b)(2) must be accorded meaning

Finally, it is nonsensical to believe that the provisions of § 1322(b)(2) kick in only after claim bifurcation. Even those courts that have interpreted § 1322(b)(2) to allow bifurcation of a claim secured by a residential mortgage

concede that a different result would be required if that interpretation left the statute "without a raison d'etre" or "led to absurdity." *In re Houghland*, 886 F.2d at 1184. The Nobelmans' interpretation of § 1322(b)(2), however, not only renders that statute meaningless, it also produces the absurd result that a statute plainly designed to accord home mortgagees *preferred* treatment, in fact, resigns them to *worse* treatment than other secured creditors under the pro-cram down philosophy.

All courts that have examined the interaction of § 506(a) and § 1322(b)(2), have acknowledged that "Congress intended to benefit residential real estate lenders." *In re Houghland*, 886 F.2d at 1185. *Accord Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 128 (3rd Cir. 1990) ("it is clear that the anti-modification provision" was "inserted on behalf of the home mortgage industry"). If, as the Nobelmans assert, a residential real estate lender can be forced to surrender its secured position in that portion of a mortgage claim that exceeds the value of the mortgaged residence, it is hard to see how § 1322(b)(2) affords the lender special protection of any significance. As the court in *In re Schum* noted, such bifurcation "would have the effect of treating real property secured by only a lien on the debtor's principal residence in the same manner as any other property secured by a lien." 112 B.R. at 162. Section 1322(b)(2), in short, would be stripped of its "raison d'etre." *Wilson*, 895 F.2d at 128. This Court should reject a construction that would render § 1322 (b)(2) meaningless. *Accord Nordic Village*, 112 S. Ct. at 1014 (a statute must be construed so that its words have some operative effect).

The Nobelmans ignore the congressionally dictated definition of "claim" in § 101(5)(A), which is a right to payment whether secured or unsecured. One court has correctly reasoned that "in order to afford § 1322(b)(2) any relevant meaning, we must find that the 'claim' referred to in this section applies to the entire claim" as defined by § 101(5) of the Bankruptcy Code and, therefore, that "this would include both the secured and unsecured potion of the creditor's claim." *In re Moran*, 121 B.R. 879, 882 (Bankr. E.D. Okla. 1990).

Rather than follow the *Houghland* line of opinions and read the general provisions of § 506 into the more specific provisions of § 1322 in order to change the meaning of the word "claim", those courts which find that § 1322(b)(2) prohibits the type of bifurcation sought by the Nobelmans actually opine that the statute means what is says. "Congress meant to establish a special protected class of creditors in a Chapter 13 case under § 1322(b)(2). To read the statute other than literally . . . is to permit inroads into a protection afforded a class of creditors by Congress." *In re Boullion*, 123 B.R. at 551. Clear statutory construction, therefore, supports denial of confirmation of the Nobelman's plan.

II.

THE COURT OF APPEALS CORRECTLY FOUND THAT THE LEGISLATIVE HISTORY OF § 1322(b)(2) PROHIBITS THE MODIFICATION OF A CLAIM SECURED BY A SECURITY INTEREST IN THE REAL PROPERTY THAT IS THE DEBTOR'S PRINCIPAL RESIDENCE.

The clear intent of Congress in enacting § 1322(b)(2) was to protect home mortgage lenders from a reduction

of their mortgage rights. *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 245 (5th Cir. 1984). "Congress intended special treatment for a creditor whose claim is secured only by a security interest in the debtor's principal residence." *In re Schum*, 112 B.R. 159, 162 (Bankr. N.D. Tex. 1990). This is equally as apparent from the evolution of the statute as from its language.

Under Chapter XIII of the Bankruptcy Act of 1898, the statutory predecessor of Chapter 13, an individual wage earner's reorganization plan could not "deal with" (*i.e.*, modify or otherwise affect) the rights of a creditor holding a claim secured by real property. Although a Chapter XIII plan could deal with other types of secured claims, "the statutory definition of the term 'claim' expressly excluded 'claims secured by estates in real property or chattels real.' " *In re Kacmarczyk*, 107 B.R. 200, 202-03 (Bankr. D. Neb. 1989) (*quoting* Bankruptcy Act of 1898, Pub. L. No. 61, 30 Stat. 544-66 (repealed 1978), § 606(1)). This resulted in "[j]udicial attempts to circumvent the rigid rule regarding treatment of secured claims in Chapter XIII, which often failed." *In re Kaczmarczyk*, 107 B.R. at 203.

Prior to enacting the Bankruptcy Code, Congress created the Commission on the Bankruptcy Laws of the United States to evaluate the existing bankruptcy laws and to recommend revisions for the reform. *Report of the Comm'n on the Bankr. Laws of the U.S.*, H.R. Doc. No. 137, 93rd Cong., 1st Sess., pt. 1, at (1973), reprinted in COLLIER ON BANKRUPTCY, App. 2 at I-1 (15th ed. 1979). The Commission suggested that in a Chapter 13 proceeding a Debtor be permitted to alter or modify claims

secured by personal property. *Id.* The Commission's proposal regarding mortgage loans was not as generous to the Debtor. The Commission suggested that the Debtor should not be allowed to modify or alter a mortgage obligation, but cure a default and continue making mortgage payments. *Id.* This new "limited authority to deal with claims secured by a lien on the Debtor's residence," the Commission stated, "does not authorize reduction of the size or varying of the time of installment payments." *Id.* House Bill 8200 chronologically followed the Commission's Report.

As originally proposed, the House version of the Bankruptcy Code completely eliminated the "rigid rule" under Chapter XIII practice by setting no limits on the ability of an individual wage earner to modify secured claims through a Chapter 13 plan. H.R. 8200, introduced before the 95th Congress, "provided that a debtor's plan might 'modify the rights of holders of secured claims or of holders of unsecured claims.' " *Grubbs*, 730 F.2d at 243-44 (quoting H.R. 8200, 95th Cong. 1st Sess. 429 (1977). Thus, as contrasted with the present language of 11 U.S.C. § 1322(b)(2) (1988), H.R. 8200 provided that any secured indebtedness could be modified, *including* indebtedness secured by a mortgage solely on the Debtor's home. At least one commentator suggests that the intent of this language was to permit "a debtor's plan to bifurcate claims into secured and unsecured claims . . . relative to personal property, not real property." Lindauer, "Optimizing the 'Fresh Start': Mortgage Cramdown under Chapter 13 of the Bankruptcy Code," 11 *J.L. & Comm.* 257, 268 (1992).

The Senate version, on the other hand, preserved the protection afforded by Chapter XIII to creditors secured

by real estate. S. 2266 provided that plans may *not* modify " 'claims wholly secured by mortgages on real property.' " *Grubbs*, 730 F.2d at 245 & n.14 (quoting S. 2266, 95th Cong., 2d Sess. (1978)). *See also* S. Rep. No. 989, 95th Cong. 2nd Sess. 141 (1978) S. 2266 would not have allowed any modifications of a debt secured by *either* commercial *or* residential real estate.

At the Senate hearings in the 95th Congress, mortgage lenders voiced concern that the House version of § 1322(b)(2) would totally abrogate the protections afforded real estate lenders under Chapter XIII. The Seventh Circuit has characterized the Senate hearings as follows:

> In the only Senate committee hearing held before the final version of S. 2266 (the Senate's bill) was introduced, secured creditors' advocated voiced no objection to the cure of default accelerations. Their opposition was directed to provisions permitting modification on a secured claim by reducing the amounts of installment payments and *reduction of the secured amount of the claim to the value of the collateral.* Hearings Before the Senate Subcommittee on Improvements of the Judicial Machinery of the Senate Committee on Judiciary, 94th Cong., 1st Sess. (1975), at 124-38 (statement on behalf of American Bankers Association), 139-84 (statement on behalf of National Consumer Finance Association). *Grubbs*, 730 F.2d at 245. At the hearings held during the 95th Congress after S. 2266 was introduced, secured creditor advocates voiced only similar objections. Hearings Before the Subcommittee on Improvements on the Judicial

> Machinery of the Senate Committee on Judiciary, 95th Cong., 1st Sess., (1977) at 652-53 (statement on behalf of National Consumer Finance Association); 703, 707, 714-15 (discouragement of savings and loan associations making home loans); 719-21 (statement of behalf of National Association of Real Estate Investment Trusts). *Grubbs*, 730 F.2d at 245 n. 13.

Matter of Clark, 738 F.2d 869, at 873-74 (7th Cir. 1984).

In testimony before the Senate Subcommittee on Improvements in the Judicial Machinery of the Committee on the Judiciary, Edward J. Kulik pointed out that reducing a mortgagee's secured claim to the actual value of any real estate securing the claim would have a dramatically negative impact on the mortgage industry. *Bankruptcy Reform Act of 1978, Hearings Before the Subcomm. on Improvements of the Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 709, 714 (1977). After focusing on commercial real estate lenders, Mr. Kulik turned his attention to the context of home mortgage funding and addressed the proposed provisions of Chapter 13. He emphasized that the House version of § 1322(b)(2) – which, unlike prior law, permitted modifications of claims secured by residential mortgages – would have a particularly adverse impact on the availability of home mortgage funds, especially where the financial resources of the individual home buyers were "not particularly strong." To avoid this result, he proposed that the legislation be modified to protect the *entire claim* secured by a residential mortgage. *Bankruptcy Reform Act of 1978, Hearing Before the Subcomm. on Improvements of the Judicial Machinery of the Senate on the Judiciary*, 95th Cong., 1st Sess. 709, 714-15 (1977).

It is against this backdrop that the compromise language embodied in present § 1322(b)(2) was adopted. This language preserves the protection afforded mortgage lenders under Chapter XIII of the Bankruptcy Act of 1898 and the Senate Bill, but restricts that protection (along the lines suggested by Mr. Kulik) to holders of claims secured by residential mortgages. The intent of this provision is explained in the Joint Explanatory Statement agreed on by House and Senate floor managers, published in the Congressional Record following the floor debates on the compromise bill (124 Cong. Rec. H11,107 (daily ed. September 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S17,424 (daily ed. October 6, 1978) (statement of Sen. DeConcini)):

> Section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate Amendment. Under the House amendment, the plan may modify the rights of holders of secured claims other than a claim secured by security interest in real property that is the debtor's principal residence. *It is intended that a claim secured by the debtor's principal residence may be treated under § 1322(b)(5) of the House amendment.*

(emphasis added).

As stated by Sen. DeConcini, the *only* permissible modification of a residential mortgage claim is that which is permitted under § 1322(b)(5). The Fifth Circuit, discussing the compromise which resulted in the final enactment, explained that:

> With regard to § 1322(b)(2), the Senate receded from its position that no 'modification' was to be permitted to *any* mortgage secured by real estate; it instead agreed to a provision that modification was to be barred only as to a claim 'secured only by a security interested in real property *that is the debtor's principal residence.*' This limited bar was apparently in response to perceptions, or to suggestions advanced in the legislative hearings, *see* note 13 *supra* [citing Mr. Kulik's testimony] that home mortgagor [*Sic*, mortgagee] lenders, performing a valuable social service through their loans, needed special protection against modification thereof (i.e. reducing installment payments, secured valuations, etc.)

Grubbs, 730 F.2d at 246 (emphasis in original). Thus, the protection afforded by § 1322(b)(2) is, as Congress recognized, appropriate and necessary.

The legislative history of § 1322(b)(2), therefore, reinforces the result reached by the Bankruptcy Court, the District Court and the Court of Appeals in this case. The intent of the statute is to preserve the availability of residential mortgage funding for individuals of modest means. The statute achieves this result by limiting any modifications of the claims of residential mortgage lenders so to entice the mortgage industry to make home loans to marginal borrowers. Nothing in the legislative history suggests that Congress intended to permit a residential mortgage lender to be "crammed-down" to the value of the collateral. Indeed, this is precisely the modification that the compromise legislation was intended to prevent.

III.

BIFURCATION OF A RESIDENTIAL MORTGAGE LIEN RUNS CONTRARY TO BASIC PRINCIPLES OF LIEN PRESERVATION UNDER BANKRUPTCY LAW.

This Court last term considered the question of whether a debtor in a chapter 7 case may " 'strip' down a creditor's lien on real property to the value of the collateral, as judicially determined, when that value is less than the amount of the claims secured by the lien?" *Dewsnup*, 112 S. Ct. at 775-76. In *Dewsnup*, the Court found a litigious debtor, who had employed several bankruptcy filings to forestall foreclosure by the secured creditor. *Id.* The debtor sought to employ in his last case the lien avoidance provisions of § 506(d) and the value reduction provisions of § 506(d) in order, in a chapter 7 proceeding, to effect an *avoidance* of the creditor's lien to the extent that it was undersecured. *Id.* In refusing to allow the debtor to use such a procedure to effect a type of "redemption" of the real property, this Court set forth several basic rules concerning the rights of secured creditors under the Bankruptcy Code. These rules are instructive to a determination of the issue now before this Court in the *Nobelman* case.

In disallowing such an avoidance, the *Dewsnup* Court looked to pre-code practice with respect to real property liens:

> This result appears to have been clearly established before the passage of the 1978 Act. Under the Bankruptcy Act of 1898, a lien on real property passed through bankruptcy unaffected. This Court recently acknowledged that this was so. See *Farrey v. Sanderfoot*, 500 U.S. ___, ___, 111

> S. Ct. 1825, 1829, 114 L.Ed.2d 337 (1991) ("Ordinarily, liens and other secured interests survive bankruptcy"); *Johnson v. Home State Bank*, ___ U.S. ___, ___, 111 S. Ct. 2150, 2154, 115 L.Ed.2d 337 (1991) ("Rather, a bankruptcy discharge extinguishes only one mode of enforcing a claim – namely, an action against the debtor *in personam* – while leaving intact another-namely, and action against the debtor *in rem*."

Id. at 778 (citing Section 67d of the 1898 Act, 30 Stat. 544, 564) (footnote omitted).

In this regard, application of the pre-Code practice to Chapter 13 proceedings mandates that the claims of residential lenders cannot be bifurcated for several reasons. First, the cram down section of Chapter 13, § 1325(a)(5)(B), requires that "the holder of such claim, retain the lien securing such claim. . . . " as a condition to confirmation. Bifurcation results in an *avoidance* of the undersecured portion of such a creditor's claim, resulting in a Debtor effecting in Chapter 13 what cannot occur under *Dewsnup* in a Chapter 7 case. Further, Chapter 13 lien bifurcation destroys the *in rem* rights which innur to the benefit of "holders of secured claims. . . . " 11 U.S.C. § 1322(b)(2). This result is not consistent with *Dewsnup*.

In addition, the *Dewsnup* Court adopted the creditor's argument, in interpreting the statutes involved, that the phrase "allowed secured claim" need not be read as an indivisable term of art. 112 S. Ct. at 777-78. "[W]e hold that § 506(d) does not allow petitioner to 'strip down' respondents' lien, because respondent's claim is secured by a lien and has been fully allowed pursuant to § 502."

Id. Such an analysis can be correctly employed in the present case.

Since American filed its claim for $71,335.04, and no objection thereto appears of record in this proceeding, this creditor holds a claim that is allowed under § 502. (Petition for Cert., App. 32-33) Further, American's claim is "secured only by a security interest in real property that is the debtor's principal residence. . . . " 11 U.S.C. § 1322(b)(2); (Petition for Cert., App. 32-33) As such, American is the holder of a claim that is within the protection of the anti-modification language of § 1322(b)(2). American's claim cannot be compromised without its consent, 11 U.S.C. § 1325 (a)(5)(A), and its lien *must* be preserved under Chapter 13 provisions. 11 U.S.C. § 1325(a)(5)(B)(i).

Preservation of American's lien is mandated also by *Dewsnup* because "[w]e think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and mortgagee." 112 S. Ct. at 778. It is recognized that real property liens survive a bankruptcy discharge. *See Johnson v. Home State Bank*, 111 S. Ct. at 2154. Nobelman's bifurcation of American's lien, however, takes away such protection from the creditor. If the Nobelmans complete their proposed plan (make all proposed payments) they would be entitled to a Chapter 13 discharge. 11 U.S.C. § 1328 (1988). American's lien would be gone under a bifurcation order and the Nobelman's will have achieved in Chapter 13 what they cannot achieve under *Dewsnup* in a Chapter 7 case.

IV.

THE LIEN STRIPPING PROVISIONS OF THE NOBELMANS' PLAN ARE AGAINST PUBLIC POLICY.

As stated in *Grubbs*, the compromise version of the proposed bill, which is now § 1322(b)(2), resulted because of perception that residential mortgage lenders deserve special protection against claim modification due to the fact that they provide a valuable social and public service through their loans – they allow for the American dream of home ownership. 730 F.2d at 246. Contrary to the dicta in *In re Houghland*, few residential lenders made loans with a sufficient equity cushion in anticipation of the dramatic drop in the national real estate market or with the expectation that courts would contravene Congress' intent behind § 1322(b)(2) and allow bifurcation. Nor have residential mortgage lenders provided residential loans to marginally secure borrowers fully expecting governmental insurance agencies to deny loan coverage in lien stripping cases, as has recently been the result. For example, the Department of Veteran's Affairs in General Counsel Memorandum. O.G.C. Precedent 91-1, has stated that "for purposes of claim payment," the debt will be reduced to the cram-down amount (resulting in the lender losing the difference). *See also* U.S. Department of Housing and Urban Development Letter No. 91-27 (June 4, 1991). The result reached by the *Houghland* and other similar courts simply ignores the public service provided by the residential mortgage lending industry which entitles it to the special protection afforded by a clear reading of § 1322(b)(2).

Even as recent as November 1990, Congress expressed its national housing objectives. In the

Cranston-Gonzales National Affordable Housing Act, Congress states: "The Congress affirms the national goal that every American family be able to afford a decent home in a suitable environment." Act of November 28, 1990, Pub. L. No. 101-625, 1991, U.S. Code Cong & Admin. News (104 Stat.) 4085, Sec. 101. If bifurcation is permitted generally, residential mortgage lenders will be forced to take the direction suggested by the *Houghland* court and require substantial down payments by home buyers in order to make available sufficient equity to protect the lender's investment. Such a loan underwriting requirement will reduce the number of qualifying borrowers significantly and, unless Congress decides to subsidize home purchases itself, will cripple the residential mortgage industry. The public service deserving protection as intended by Congress under § 1322(b)(2) must be preserved.

Further, the Nobelmans' construction of § 1322(b)(2) is inconsistent with the statutory scheme of Chapter 13. A Chapter 13 debtor is plainly entitled to a "fresh start". Bifurcating a residential mortgage debt provides a Chapter 13 debtor in a depressed real estate market with much more than a fresh start: it accords the Debtor a windfall. *See Dewsnup*, 112 S. Ct. at 778. Such a windfall occurs when a debtor is permitted to retain a home, "cram-down" the creditor to the depressed value of the property, and enjoy the benefit of any subsequent appreciation in the value of the property when market conditions improve – all with no obligation to pay the mortgage lender anything more than the reduced amount of the debt. Such appreciation in value "rightly accrues to the benefit of the creditor, not to benefit of the debtor . . . " *Id.*

This is precisely the abuse that residential mortgage lenders urged Congress to acknowledge and that was addressed in the compromise statutory language. The Nobelmans would have American Savings Bank take the loss for the drop in real estate values, but they want no part of such loss themselves. Further, it is doubtful that, had the property value *increased*, the Nobelmans would have shared such benefit with their lender by agreeing to pay *more* than the original loan amount.

The unfairness of the result sought by the Nobelmans here is compounded by the fact that interpreting § 1322(b)(2) to allow "cram-down" provides no immediate relief to Chapter 13 debtors and does not insure that the Debtor will be able to retain the mortgage residence. Given that a Chapter 13 Debtor may not alter the monthly payment schedule set forth in the mortgage note, reduction of the amount of the mortgage debt merely allows the Debtor to pay off the mortgage at an earlier date. There is no immediate relief to the debtor in the form of a reduced mortgage payment and thus no assistance in constructing a monthly payment schedule which would result in a confirmable plan.

Further, the Bankruptcy Code requires that bankruptcy cases under Chapter 13 be proposed "in good faith . . . " 11 U.S.C. § 1325 (a)(3) (1988). Although not addressed as a basis for denial of plan confirmation by the Bankruptcy Court, American did raise the good faith issue in its Objection to Confirmation of Chapter 13 Plan. As stated in the Bankruptcy Court's Finding of Fact, the Nobelmans propose to pay *nothing* to unsecured creditors under their plan. Certain courts have held that zero payment plans abuse the spirit of Chapter 13. *See In re*

Lattimore, 69 B.R. 622, (Bankr. E.D. Tenn. 1987); *Matter of Hurd*, 6 B.R. 329 (Bankr. D. Ind. 1980). The plan proposed by the Nobelmans in this case, in fact, reaches a level of abuse indicative of a lack of good faith.

The plan in this case would result in the Nobelmans obtaining ownership of their home free of the lien of American after payment of the "cram-down" value of the real property, with the bifurcated unsecured portion of the creditor's claim being discharged under § 1328. Such a result would enable the Nobelmans to force upon the creditor a type of "redemption," see 11 U.S.C. § 722 (1988), that is *not* otherwise available in Chapter 7 cases. Under § 722, a Chapter 7 debtor may redeem *personal* property from a creditor by paying the amount of the allowed *secured* claim. Redemption of real property under Chapter 7 is not provided for by the Bankruptcy Code. Thus, the Nobelmans are attempting by their plan to force the American into a *worse* position than that in which it would be in if this were a Chapter 7 case. At least in Chapter 7, American could elect to exercise its right to foreclose (after stay termination) and realize the benefit if immediate proceeds or possession of its collateral.

This Court, reviewing the Nobelmans' zero payment and the Chapter 13 abuse, together with public service provided by the mortgage industry, should affirm the Court of Appeals' opinion order denying confirmation.

CONCLUSION

For the above and foregoing reasons, American Savings Bank, F.A. respectfully requests that this Court affirm the Order of the United States Court of Appeals for the Fifth Circuit entered on August 13, 1992.

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND
HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

**On Writ Of Certiorari To The
United States Court Of Appeals
For The Fifth Circuit**

BRIEF ON THE MERITS FOR RESPONDENT, STANDING CHAPTER 13 TRUSTEE

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STATEMENT OF THE ISSUES

WHETHER THE BANKRUPTCY COURT, DISTRICT COURT AND COURT OF APPEALS ERRED IN RULING THAT DEBTORS' CHAPTER 13 PLAN MAY NOT EMPLOY 11 U.S.C. SECTION 506 TO BIFURCATE A MORTGAGE LIEN CLAIM ON DEBTORS' PRINCIPAL RESIDENCE INTO ALLOWED SECURED AND UNSECURED CLAIMS AND PROVIDE FOR MODIFICATION OF THE ALLOWED UNSECURED CLAIM WITHOUT VIOLATING 11 U.S.C. SECTION 1322(b)(2)?

STATUTES WHICH THE CASE INVOLVES

11 U.S.C. Section 101. Definitions.

In this title –

(5) "claim" means –

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured.

(12) "debt" means liability on a claim.

(37) "lien" means charge against or interest in property to secure payment of a debt or performance of an obligation.

11 U.S.C. Section 349. Effect of Dismissal.

(b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under Section 742 of this title –

(1) reinstates –

(B) any transfer avoided under Section 522, 544, 545, 548, 549, or 724(a) of this title, or preserved under Section 510(c)(2), 522(i)(2), or 551 of this title; and

(C) any lien voided under Section 506(d) of this title;

(3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

11 U.S.C. Section 363. Use, sale, or lease of property.

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if –

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property.

(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the

holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. Section 502. Allowance of claims or interests.

(a) A claim or interest, proof of which is filed under Section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under Chapter 7 of this title, objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h), and (i) of this section if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

(2) such claim is for unmatured interest;

(3) if such claim is for a tax assessed against property of the estate, such claim exceeds the value of the interest of the estate in such property;

(4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services;

(5) such claim is for a debt that is unmatured on the date of the filing of the petition and that is excepted from discharge under Section 523(a)(5) of this title;

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates;

(7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds –

(A) the compensation provided by such contract, without acceleration, for one year following the earlier of –

(i) the date of the filing of the petition; or

(ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

(B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates; or

(8) such claim results from a reduction, due to late payment, in the amount of an otherwise applicable credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor.

11 U.S.C. Section 506. Determination of secured status.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless –

(1) such claim was disallowed only under Section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of claim under Section 501 of this title.

11 U.S.C. Section 522. Exemptions.

(a) In this section –

(1) "dependent" includes spouse, whether or not actually dependent; and

(2) "value" means fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such date, as of the date such property becomes property of the estate.

(b) Notwithstanding Section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. In joint cases filed under Section 302 of this title and individual cases

filed under Section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Bankruptcy Rules, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (2) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is –

(1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

(2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

(c) Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined

under Section 502 of this title as if such debt had arisen, before the commencement of the case, except –

(2) a debt secured by a lien that is –

(A)(i) not avoided under subsection (f) or (g) of this section or under Section 544, 545, 547, 548, 549, or 724(a) of this title; and

(ii) not void under Section 506(d) of this title; or

(B) a tax lien, notice of which is properly filed; or

(g) Notwithstanding Sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under Section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if –

(1)(A) such transfer was not a voluntary transfer of such property by the debtor; and

(B) the debtor did not conceal such property;

11 U.S.C. Section 524. Effect of discharge.

(a) A discharge in a case under this title –

(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; and

(3) operates as an injunction against the commencement or continuation of an action, the employment of

process, or an act, to collect or recover from, or offset against, property of the debtor of the kind specified in Section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under Section 523, 1228(a)(1), or 1328(a)(1) of this title, or that would be so excepted, determined in accordance with the provisions of Sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.

(e) Except as proved in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.

11 U.S.C. Section 1307. Conversion or dismissal.

(b) On request of the debtor at any time, if the case has not been converted under Section 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable.

11 U.S.C. Section 1322. Contents of plan.

(b) Subject to subsections (a) and (c) fo this section, the plan may –

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.

11 U.S.C. Section 1325. Confirmation of plan.

(a) Except as provided in subsection (b), the court shall confirm a plan if –

(5) with respect to each allowed secured claim provided for by the plan –

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder.

11 U.S.C. Section 1327. Effect of confirmation.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the

debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

11 U.S.C. Section 1328. Discharge.

(a) As soon as practicable after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under Section 502 of this title, except any debt –

(1) provided for under Section 1322(b)(5) of this title.

STATEMENT OF THE CASE

Course of the Proceedings and Disposition in Courts Below. The United States Bankruptcy Court for the Northern District of Texas, Honorable Harold C. Abramson presiding, entered on February 12, 1991, its Findings of Fact and Conclusions of Law denying Confirmation of the Chapter 13 Plan of Leonard and Harriet Nobelman. The Nobelmans appealed and on June 24, 1991, the United States District Court for the Northern District of Texas, Honorable Barefoot Sanders presiding, entered its Memorandum Opinion and Order affirming the decision of the Bankruptcy Court. The Nobelmans appealed from that Order to the United States Court of Appeals for the Fifth Circuit, which affirmed the decision below on

August 13, 1992, and Certiorari was subsequently granted by this Court.

STATEMENT OF FACTS

The facts presented in this appeal are essentially undisputed. American Savings Bank, F.A. (hereinafter "A.S.B.") is the owner and holder of an adjustable rate note executed by the Nobelmans on June 21, 1984, in the amount of $68,250.00 (the "Note"). The Note is secured by a purchase money Deed of Trust on a condominium which is the Nobelmans' principal residence. The Note provides for an initial rate of interest of 7.5%, which is to be adjusted every 12 months through 1987 and every 60 months thereafter, beginning August 1, 1987, until maturity on July 1, 2014. Payment amounts are specified in the Note until the 1987 adjustment, after which the adjusted payments are to be calculated on the basis of the new interest rate, the outstanding principal and the remaining term of the loan. Murray Mortgage Company is the duly authorized servicing agent for A.S.B.

The Nobelmans filed a voluntary Chapter 13 Bankruptcy Petition on August 6, 1990. On August 14, 1990, A.S.B. filed its Proof of Claim for $71,265.04, which was amended on October 2, 1990, to $71,335.04. On October 25, 1990, the Nobelmans filed their Modified Chapter 13 Plan and Motion for Valuation ("Plan"), which valued the residence at $23,500.00. The Plan proposed to pay direct to A.S.B. only that amount as a secured portion of its claim, and proposed to cure pre-Petition arrearages through the Plan. The balance of the claim would be

treated through the Plan as a general unsecured claim. The Plan makes no provision regarding the method of amortization of principal and interest as a result of the adjustment of the rate of interest in accordance with the Note and/or the "cramdown" provided for in the Plan.

On November 5, 1990, A.S.B., through its agent, filed its Objection to Confirmation of the Nobelmans' Plan. The Objection stated that the Plan violated 11 U.S.C. Section 1322(b)(2) by impermissibly modifying A.S.B.'s claim. Tim Truman, predecessor to Molly Bartholow, Standing Chapter 13 Trustee, filed his Objection to Confirmation on November 27, 1990, also asserting that the Plan violated Section 1322(b)(2). The hearing on Confirmation was held on December 6, 1990. No party offered evidence controverting the valuation placed by the Nobelmans on their residence. On February 14, 1991, the Bankruptcy Judge entered his Findings of Fact and Conclusions of Law, sustaining the objections of A.S.B. and the Trustee. That ruling by the Bankruptcy Court was affirmed by the District Court and the United States Court of Appeals for the Fifth Circuit.

SUMMARY OF THE ARGUMENT

Appellants argue that Section 506(a) of the Federal Bankruptcy Code should be able to effect a "strip down" of the Nobelmans' homestead mortgage holder's lien. Only after the 506(a) "strip down" do Appellants apply 1322(b)(2) to assert that the then stripped claim of the mortgage lender can be modified so as to avoid payment of the undersecured portion of the debt, a "Zero Percent"

dividend can be paid to unsecured creditors and the debtors' liability thereon can be discharged if all plan payments are made.

Respondent-Trustee maintains that both assertions by the Appellants are incorrect.

This Court in its recent opinion, *Dewsnup v. Timm*, 112 S.Ct. 773 (1992), made clear that 506(a) did not provide debtors with a "broad new remedy" involving the right to "strip down" liens solely because of a lack of equity. The *Dewsnup* case is illustrative of the present Chapter 13 case because this court was unequivocal that 506(a) "strip down" of liens was not a permissible remedy in the Chapter 7 context. Consequently, without a reorganization chapter's extra "cram down" powers, neither the general provisions of the Bankruptcy Code nor the provisions of Chapter 7 authorized the Section 506 "strip down" requested by the *Dewsnups*. Appellants' argument herein fails since their 1322(b)(2) analysis springboards entirely upon an affirmative finding that, by itself, 506(a) had worked a lien "strip down" which finding was specifically denied in *Dewsnup* and by the Fifth Circuit in *In re Nobelman*, 968 F.2d 483 (5th Cir. 1992).

Respondent-Trustee maintains that Section 506(a) is not a self actualizing section that is capable of altering secured debt. Instead, 506(a) is designed to assist the bankruptcy process to be able to determine the value of a secured claim at different times and for different purposes throughout a bankruptcy case. It cannot act by itself to affect a creditor's interest and can only be applied in conjunction with some other action dealing

with a proposed disposition, use or plan. If Section 506(a) does not by itself affect a secured debt, some other action taken in the bankruptcy case must serve as the catalyst to kick off Appellants' requested relief of debt "strip down."

Section 1322(b)(2) is the only other section relied upon by the Appellants to support their theory that the homestead debt and lien herein may be "reduced." The mandate in the "other than" clause of Section 1322(b)(2) against a plan provision that would modify the "rights" of holders of a claim secured by the debtors' homestead prevents the Nobelmans' plan from reducing the homestead mortgage debt, whether by way of Section 506(a) or otherwise. Post-*Dewsnup* cases to the contrary, such as *Bellamy v. Federal Home Loan Mortgage Co.*, 962 F.2d 176 (2d Cir. 1992), do not properly apply *Dewsnup* or interpret the import of the "other than" clause. They fail to recognize that Section 1322(b)(2) broadly prohibits modification of a lienholders's rights, and they misread Section 506(a) in relation to Section 1322(b)(2).

Neither statutory construction rules nor legislative history support Appellants' argument for the application of 506(a) and 1322(b)(2) to "strip down" liens of homestead mortgage holders. The Fifth Circuit held that the plain meaning of 506(a) and 1322(b)(2) appeared to conflict. Consequently, in *Nobelman* the Fifth Circuit held that the specific provisions of 1322(b)(2) controlled over the general provisions of 506(a) and, after review of the legislative history of 1322(b)(2), determined that 1322(b)(2) prohibits the modification of the "rights" of holders of claims secured by a home mortgage and that the claim, both secured and unsecured, if any, could not be modified.

Finally, the Bankruptcy Code does not support the concept of the "strip down of liens" outside the special provisions found in the reorganization chapters that allow "cram down" in limited exceptions to the general rule. Just like it is hard to see the whole picture when you can only see two strands of thread in a tapestry, it is hard to see the whole bankruptcy picture if you focus only on 506(a) and 1322(b)(2). It is imperative to look at the whole fabric of the Bankruptcy Code to understand its purpose. Here, the Appellants' proposed 506(a) "strip down" must be put in context with other sections of the Code that would be impacted such as 502 allowance of claims, 524 and 1328 discharge, 363 sales of assets, 349 dismissals and with regard to a Chapter 13 plan, the interplay of 1322(b)(2) with 1322(b)(5) long term debt, 1325(a)(5) confirmation, and 1327 (b) and (c) vesting of property in the debtor after the confirmation of a Chapter 13 plan. A review of these other key sections makes clear that the bankruptcy picture does not convey that liens be "stripped" except in very limited circumstances which circumstances do not include Chapter 13 homestead mortgages. In this regard, the Fifth Circuit in *Nobelman* specifically acknowledged the Second Circuit's *Bellamy* decision but rejected *Bellamy*'s ruling permitting 506(a) bifurcation of home mortgage claims.

ARGUMENT AND AUTHORITIES

I. The teachings of Dewsnup: The Scope of Section 506(a).

In *Dewsnup v. Timm*, 112 S.Ct. 773 (1992) this Court considered the relationship of Sections 506(a) and (d) in the context of a Chapter 7 case. That case clearly established that Section 506(a) is not to be mechanistically applied to bifurcate liens for all purposes. Rather, Section 506(a)'s impact must be considered in the overall context of the Code and pre-Code practice and provisions. *Dewsnup* teaches that Section 506(a) does not, by itself, provide a basis for avoiding a lien on the undersecured portion of a secured debt. Instead, Section 506(a) merely sets forth a basis for establishing relative values in order to enable a fair distribution to secured and unsecured creditors.

Although Section 506(a) is an element of the lien-splitting equation, *Dewsnup* requires an additional statutory catalyst to effectuate the remedy sought by the debtor. In *Dewsnup*, this Court considered and rejected the Chapter 7 debtor's argument that Section 506(d) was the catalyst that allowed him to reduce the secured claim to its present value and void the secured creditor's lien. In doing so, it declined to create a remedy under Section 506(a) that was not clearly articulated in the Code or the legislative history:

> "When Congress amends the bankruptcy laws, it does not write 'on a clean slate'. Furthermore, this Court has been reluctant to accept

> arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history. Of course, where the language is unambiguous, silence in the legislative history cannot be controlling. But given the ambiguity here, to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the extent that they become 'unsecured' for purposes of Section 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles." *Dewsnup*, at 779. [Citations omitted.]

As the Court points out, there is nothing in Section 506(a) or the provisions of the Code with which it interacts to serve as grounds for a dramatic change in pre-Code principles that allow survival of liens *in rem* in order to allow secured creditors adequate rights, not inconsistent with the purposes of the Code, to realize maximum benefit from its collateral.[1]

To this end the Court considered favorably the arguments that the "fresh start" doctrine does not extend to discharge an *in rem* claim against property, but that creditors should retain the benefit of their liens:

> "We think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee. . . . *Any increase*

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[1] See the related discussion in Section IV below.

over the judicially determined valuation during the bankruptcy rightly accrues to the benefit of the creditor, and not to the benefit of the debtor and not to the benefit of the unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee relationship." *Dewsnup*, at 778. (emphasis added).

II. Application of Dewsnup to Nobelman.

The concepts articulated by this Court in *Dewsnup* are directly analogous in this case. Just as in *Dewsnup*, the Nobelmans seek first to apply Section 506(a) to reduce the amount of the secured claim on their home and then to invoke Section 1322(b)(2) as the catalyst to void the undersecured portion of the lien and discharge the unsecured claim which they seek to establish through application of Section 506(a).[2]

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[2] Cases decided at the Circuit court level permitting bifurcation of homestead liens include: *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989); *Wilson v. Commonwealth Mortgage*, 895 F.2d 123 (3rd Cir. 1990); *In re Hart*, 923 F.2d 1410 (10th 1991); *Sapos v. Provident Institution of Savings*, 967 F.2d 918 (3d Cir. 1992); *Bellamy v. Federal Home Loan Mortgage Co.*, 962 F.2d 176 (2d Cir. 1992); and *Lomas Mortgage USA v. Wiese*, 1992 WL 354917 (9th Cir. 1992). Cases refusing to permit bifurcation include: *In Boullion*, 123 B.R. 549 (Bkrtcy. W.D. Tex. 1990). *In re Sauber*, 115 B.R. 197 (Bkrtcy. D. Minn. 1990); *In re Christiansen*, 121 B.R. 63 (Bkrtcy. D. Colo. 1990); *In re Moreland*, 124 B.R. 921 (Bkrtcy. D. Conn. 1991); *In re Mitchell*, 125 B.R. 5 (Bkrtcy. 1991); *In re Etchin*, 128 B.R. 662 (Bkrtcy. W.D. Wis. 1991). Lower court decisions in the Fifth Circuit permitting bifurcation include: *In re Session*, 128 B.R. 147 (Bkrtcy. E.D. Tex. 1991); *Federal Sav. Bank v. Dunlap*, (E.D. La. 1991); and *In re Franklin*, 126 B.R. 702 (Bkrtcy. N.D. Miss. 1991).

However, as in the case of Section 506(d), the Code and the legislative history of Section 1322(b)(2) are devoid of clearly articulated indications that Congress intended the "broad new remedy" which the Nobelmans seek to establish.[3] Accordingly, Section 1322(b)(2) is likewise not the catalyst that charges Section 506(a) with the power to bifurcate or void liens.

The legislative history of Section 1322(b)(2) indicates that the "other than" clause was inserted into Section 1322(b)(2) in response to perceived needs for protection of the home mortgage industry.[4] Prior law precluded any cramdown of any "estates in real property"[5] and there is no indication in the legislative history of Section 1322(b)(2) that the protective exception in the "other than" clause was intended to permit a cramdown of home mortgages.

Indeed, the *Nobelman* decision below finds that the legislative history as an additional basis for its holding, pointing out that in the Congressional negotiations the Senate receded from its position that there be "no modification" of real estate liens and acquiesced in a provision that precluded modification of home mortgages only.

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[3] The marked split in authority on this issue makes it self-evident that the Code itself does not provide the clear delineation of new remedies that *Dewsnup* requires.

[4] Brief of Appellant, at 13-17; *Bellamy*, 962 F.2d 176, 181-182 (2d Cir. 1992). Amicus briefs in support of Respondents' position in this case delineate the specific concerns of the thrift industry.

[5] *Bellamy*, 962 F.2d 176, 181 (2d Cir. 1992).

Acknowledging an apparent need to provide stability and protection to the thrift industry, the court concluded:

> "We believe our interpretation of Section 506(a) and Section 1322(b)(2) reflects this compromise. . . . The bifurcation of an undersecured home mortgage runs afoul of the specific protection afforded under Section 1322(b)(2) to home mortgage creditors whose claims are secured only by a debtor's principal residence. Section 506(a) cannot be used to bifurcate the claim and vitiate the protection of Section 1322(b)(2)." 968 F.2d 489.[6]

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[6] *See also In re Sauber*, 115 B.R. 197 (Bankr. N.D. Minn. 1990), in which the court noted that Congress had clearly provided home mortgagees with protection in their treatment under the Bankruptcy Code, and the only explicit exception is the Section 1322(b)(5) cure provision. As stated by Judge O'Brien:

> "That Congress has provided certain home mortgagees with protection against the modification of their rights which might otherwise result through application of Section 506(a) in Chapter 13 cases, is a simple and logical conclusion, readily drawn from reading Sections 1322(b)(2) and (b)(5). And, it is not surprising. The vast majority of Chapter 13 cases are filed by homeowners, and most plans treat mortgage defaults. Sections 1322(b)(2) and (b)(5), in a relatively simple and straight-forward manner, protect the home loan industry from perceived adverse consequences that might otherwise result from general application of Section 506(a) to it in Chapter 13 cases.
>
> "The protection afforded preserves the integrity of the mortgage contract, with the limited exception of allowing a debtor a reasonable period in which to cure defaults." *Id.*, at 199.

Nobelman also holds that the more specific provisions of Section 1322(b)(2) should govern over the general provisions of Section 506(a). This, by itself, provides a sound basis for affirming the decision below.

Cases such as *Bellamy*,[7] decided after *Dewsnup*, fail to interpret Section 1322(b)(2) as precluding lien splitting. In so doing, they do not apply *Dewsnup* correctly, since they fail to follow *Dewsnup*'s teachings that Section 506(a) does not, by itself, support bifurcation of liens.

Bellamy distinguishes *Dewsnup* on the basis of "differing language" in 506(d) and 1322(b)(2), and asserts that both 1322(b)(2) and 506(a) deal with "secured claims," whereas 506(d) was concerned with "liens." This analysis misses the mark. As discussed in more detail below, Section 1322(b)(2) deals with "rights," not claims, and specifically prohibits modification of the rights. Moreover, the *Bellamy* court's interpretation of Section 1322(b)(2) could not have a more direct impact on the liens in question since the effect of its ruling is to render valueless important aspects of a secured creditor's lien.

The assertion that Section 506(a) deals with claims and not liens is correct[8], but absent other provisions to implement it, the effect is only to establish relative rights to distribution with respect to claims treated in a Chapter 13 plan. Its purpose is to enable an equitable distribution

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[7] The *Bellamy* decision provides the most thorough post-*Dewsnup* analysis in support of lien stripping and will accordingly be discussed in some detail in this brief.

[8] Indeed, the word "lien" does not appear in Section 506(a), and yet Petitioner seeks to use it as the springboard for voiding the liens of a secured creditor.

among secured and unsecured creditors and not as a sword with which to void liens. As was the case with respect to Section 506(d) in *Dewsnup*, the broader power to limit or eliminate rights, claims or liens protected by 1322(b)(2) is nowhere contained in Section 506(a).

Bellamy and those cases which follow it pay lip service to *Dewsnup* and Section 1322(b)(2) with statements to the effect that "bifurcation" under 506(a) is somehow not a "modification" under Section 1322(b)(2). They purport to give meaning to the "other than" clause by acknowledging the obvious intent which it embodies to "provide greater protection to home mortgage lenders than other secured creditors in the Chapter 13 context" and conclude that this objective is met by precluding a reduction in the mortgage payment pending payout of the bifurcated secured claim.[9] Thus is it dubiously maintained that a nominal change in interest rate or payment amount on the Nobelmans' homestead note would constitute an impermissible modification of the lender's rights, while a $50,000 reduction in the principal amount owing does not.

Aside from the questionable logic of this position, it is itself a non-sequitur: since the contractual payment terms relate both to the secured and unsecured portion of the bifurcated claim, the requirement that they may not be altered imposes restrictions on modification that go beyond the narrow limits of the secured portion of the

[9] *See e.g., Bellamy*, 962 F.2d at 184-5.

claim.[10] Moreover, interpreting the "other than" clause in this fashion renders it largely redundant with Section 1325(a)(5)(B)(ii), which guarantees, even absent Section 1322(b)(2), that the holder of a secured claim will receive the value of the secured portion of the claim. Therefore the minimal rights which would be protected from modification under this interpretation are largely illusory.

The application of these concepts becomes even more tenuous when, as in the instant case, the note and lien in question provide for adjustment in the payment amounts based on an adjustable rate of interest. In these circumstances, the applicable contractual provisions normally require the payment to be adjusted to reflect the actual interest rate and principal amount on each adjustment date. Do those cases which hold that a change in the amount of payment is a modification of the noteholder's rights require that the adjusted payment be computed on the basis of the face amount of the loan or of the reduced

[10] Courts applying this principle have developed a variety of interpretations and refinements dealing with particular individual circumstances. *See e.g., In re Brouse*, 110 B.R. 539, 544 n.7 (Bankr. D. Colo. 1990) (no change in interest rate); *In re Honett*, 116 B.R. 495, 497-98 (Bankr. E.D. Tex. 1990); *In re Hayes*, 111 B.R. 924, 926-27 (Bankr. D. Or. 1990) (no change in payments or interest rate); *In re Hyden*, 110 B.R. 46, 51, clarified & motion for reconsideration denied, 112 B.R. 431 (Bankr. W.D. Okla. 1990) (no change in payments or interest rate); *In re Demoff*, 109 B.R. 902 (Bankr. N.D. Ind. 1989) (duty to pay insurance and taxes and duty not to commit waste remains unaffected); *In re Morphis*, 30 B.R. 589, 593-94 (Bankr. N.D. Ala. 1983) (a reduction of the monthly payment is permissible because the mortgagee is entitled to the same treatment mandated under Section 1325(a)(5)(B)).

and bifurcated amount of the secured claim? If the former, how will the amortization of principal and interest be determined? If the latter, literal application of the contractual provision would "protect" a secured creditor by mandating a much reduced payment over the original term of the loan. That the Code and the legislative history of Section 1322(b)(2) make no provision for these questions and afford the federal judiciary no guidance as the methods to be employed in re-amortizing the debtors' loans is an additional indication that Congress did not intend Section 1322(b)(2) to authorize lien stripping.

III. Analysis of Section 1322(b)(2).

Section 1322(b)(2) provides as follows:

> "(b) Subject to subsections (a) and (c) of this section, the plan may –
>
> (2) modify the *rights of holders* of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims." (emphasis added)

A critical element of Appellant's argument in this case is that the "other than" clause highlighted above must be read to modify the words "secured claims" solely and only because those words directly precede the clause itself. This is only one of several possible constructions, and it does not comport with the common sense meaning of the "other than" clause.[11]

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[11] See note 6 supra and related text.

Respondent-Trustee submits that a reading of this provision with the implied addition for clarification of the bracketed language indicated below is equally plausible grammatically, and better suits the overall workings of the Code and the Congressional intent:

> "(2) modify the rights of holders of secured claims, other than [*the rights of a holder of*] a claim secured only by . . . "

This reading properly shifts the emphasis of the provision to one which is designed to protect the *rights of holders* of claims, not just the claims themselves and underscores the intention of Congress to protect the *holders* of secured claims from any modification of their rights.

For example, *Bellamy* specifically acknowledges Section 1322(b)(2) precludes modification of "rights."[12] It casts the issue as whether this means rights of the "holder" of a claim which happens to be secured, or whether it is addressing the holder's rights with respect only to the "secured claim." The court parrots a supposed "cornerstone" of the Code that "treatment under the Code turns on whether a *claim* is secured or unsecured, not whether a *creditor* is secured or unsecured,"[13] ignoring the fact that express language of 1322(b)(2) speaks of the "rights of a holder" of a secured claim.

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[12] "Acknowledging that [Section 1322(b)(2)] prohibits modification or a residential mortgagee's rights does not answer the ultimate question to be decided – what are those rights?" *Bellamy*, 962 F.2d at 179.

[13] *Bellamy*, 962 F.2d, at 179.

This rote application of a sometimes valid principle is not warranted here. Significantly, the phrase "rights of a holder" is unique in the Code to Sections 1322(b)(2) and 1222[14]. Thus, the cases relied on in *Bellamy* for this proposition are interpreting different statutory language. In contrast, it is patently untenable to assert that the words "rights of holders of secured claims" makes reference only to claims and somehow does not address the holders themselves and their rights.

The *Bellamy* court also attempts to differentiate between "rights" (which are said to arise under state law) and the "manner in which the rights are satisfied" (which is said to be fixed by the Code and not a "right" protected by the "other than" clause).[15] In doing so, it invokes the Code's definition of "claim" (Section 101(5)(A)) as "right to payment" and implicitly postulates that the right to payment is thus equivalent to a claim[16] and therefore not one of the state law "rights" protected by the "other than" clause. Having thus defined a right specified in the Code as a mere "claim," it then concludes that since the Code and not state law govern the manner of payment of claims, "bifurcation" and cramdown is not a "modification" of the right/claim, only a determination of how the right/claim is to be satisfied.

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[14] Section 1222 is patterned after 1322, but does not include the "other than" clause. It was enacted with Chapter 12 in 1985, so the differences between Sections 1322 and 1222 are not relevant to a consideration of the legislative intent when Section 1322 was enacted in 1978.

[15] *Bellamy*, 962 F.2d at 179-80.

[16] This is like defining blue as a color and then concluding that all colors are blue.

This logic is circular and assumes the conclusion in two respects. First, the right to payment is indeed one of the bundle of rights available to a holder of a claim.[17] Under *Dewsnup*, the bundle must necessarily include a right to receive "any increase over the judicially determined valuation," which "rightly belongs to the creditor."[18] But it certainly does not follow from the Code's reference to this right in its definition of a "claim" that the holder of a claim has no cognizable rights other than the right to payment. Second, it assumes that the holder of a claim has no rights in determining how a claim is to be satisfied. Once again, the court assumes its conclusion, overlooking the essence of the issue at hand. The very

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[17] These rights include:

"1. The right to retain the lien until the indebtedness thereby secured is paid.
2. The right to realize upon the security by a judicial public sale.
3. The right to determine when such sale shall be held, subject only to the discretion of the court.
4. The right to protect its interest in the property by bidding at such sale, whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.
5. The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt." *In re Barnes*, 146 B.R. 854 (Bankr. W.D. Okla 1992) citing from *Louisville Joint Stock Bank v. Radford*, 295 U.S. 555, 594-595, 55 S.Ct. 854, 865, 79 L.Ed. 1593 (1935).

[18] *Dewsnup*, at 778, quoted supra.

right that the mortgage holder seeks in this case to preserve is the right to determine the manner of payment under terms embodied in the mortgage and contractually committed to by the debtor.

Bellamy also supports its interpretation of the statute and the legislative history by reference to oft-cited principles embodied in the Code and Chapter 13 – those of fostering a "fresh start" and "favoring reorganization," suggesting that these principles require a reading of Section 1322(b)(2) that denies it any substantive meaning. Laudable as those principles may be, they are obviously subject to reasonable limits in their applicability. They do not guarantee reorganizations that are clearly not feasible under applicable laws and do not mandate a "fresh start" that permits every debtor an equity interest in a home, free from the threat of foreclosure or eviction on account of debts they cannot support.[19]

The *Bellamy* court begins its opinion with a statement in the first sentence that "Congress in the Bankruptcy Code provided that residential mortgages secured by liens could be broken down into two parts."[20] In discussing the options available to the debtor in that case it states: "If appellant's definition of modification (as encompassing bifurcation) was correct, a debtor wishing

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[19] *Cf. Dewsnup*, 112 S.Ct. at 777, wherein this Court quoted favorably from the respondent's argument:

"[T]he 'fresh start' policy cannot justify an impairment of respondents' property rights, for the fresh start does not extend to an *in rem* claim against property, but is limited to a discharge of personal liability."

[20] *Bellamy*, 962 F.2d at 177.

to retain his overencumbered home would face this quandry – pay off its actual value within five years (most likely an impossible proposition, thereby precluding confirmation (see Section 1325(a)(6)), or pay more than market value."[21] The court's analysis overlooks Section 1325(a)(5)(C) which affords the debtor a third alternative provided by Congress in a case such as this: "the debtor surrenders the property securing such claim to such holder."

From the perspective of a standing Chapter 13 Trustee, Respondent-Trustee respectfully submits that there is a substantial number of cases in which resort to 1325(a)(5)(C) is the only appropriate alternative of those outlined by the *Bellamy* court. A decision by this Court that makes it possible to achieve a substantial reduction in an undersecured homestead mortgage by the simple expediency of filing a Chapter 13 bankruptcy will open the door for widespread abuse of the bankruptcy system.

IV. Section 1322(b)(2) in the Context of the Bankruptcy Code.

Bankruptcy is a process whereby the debtor presents his nonexempt property for the payment of his allowed claims in exchange for the debtor obtaining a discharge of debts. The bankruptcy process, then, requires the debtor to disclose and value assets, creditors to state amounts due by the debtor and the basis therefor, payment of the claims allowed and ultimately, discharge for the debtor.

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[21] *Id.*, at 185.

The holding is *Dewsnup* that the secured creditor's lien passed through the bankruptcy is consistent with the application and flow of the bankruptcy process and is supportive of the Fifth Circuit's holding in *Nobelman* that the homestead mortgage lien herein could not be bifurcated or debt reduced. As shown below the Bankruptcy Code consistently supports the concept that the secured creditor retains his lien and that the lien passes through bankruptcy.

Claims allowance pursuant to Section 502. With regard to claims, Section 502 provides that claims timely filed are allowed unless objected to. Note that Section 502(b) does not list as an authorized objection to secured claims a lack of equity in collateral pursuant to 506(a). In short, a mortgage holder has an allowed claim in bankruptcy if the lien is valid and the claim is timely filed. The issue of the value of collateral does not enter into the determination of the 502 allowance of the claim. *See Dewsnup* at 778. In the instant case, it is undisputed that no objection was raised to the allowance of the claim of the Nobelmans homestead mortgage lender.[22]

Discharge pursuant to 524 and 1328. As pointed out by this Court in *Dewsnup*, discharge in the Bankruptcy Code is designed to be a release of personal liability and not an

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[22] The Fifth Circuit has consistently held that a secured creditor with an allowed secured claim is not bound by a Chapter 13 plan when no objection to the claim has been filed. In such instances, the liens have been held to pass through the bankruptcy case unaffected. *Sun Finance Company, Inc. v. Howard*, 972 F.2d 639 (5th Cir. 1992), *Simmons v. Savell*, 765 F.2d 547 (5th Cir. 1985).

in rem release of lien. Section 524 and Section 1328, both support that view.[23]

Section 524(a)(2) provides that discharge operates as an injunction against various collection activities with regard to debt of the debtor "as a personal liability." Section 524(a)(3) allows an injunction to collection activities with regard to prepetition debt only on post petition acquired property. Consequently, creditors with a prepetition lien on prepetition property do not have the lien discharged nor the debt discharged by virtue of Section 524; however, the debt has become a nonrecourse debt that can be satisfied by the collateral only.

Section 524(e) again emphasizes that the debt remains after discharge by referring to the effect of discharge on transactions involving third parties. As set out in 524(e), third party non-debtors do not get a discharge and their property is not relieved from debt on account of a debtor's discharge.

Section 524(e) vividly illustrates that the debtor, at discharge, only gets a personal liability release. For example, encumbered realty owned in common by a debtor and a non-debtor is subject to foreclosure for the full amount of the mortgage debt notwithstanding the fact that one of the original mortgagors filed a bankruptcy case and obtained a discharge. If under these hypothetical facts the realty at foreclosure did not satisfy the mortgage debt, the lender could pursue the non-debtor for a personal judgment for the deficiency but the 524 discharge would prevent the lender from pursuing the

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[23] *Dewsnup*, at 778.

debtor. In short, Section 524 discharge does not include the concept of "stripping" of liens or of voiding of liens.

The discharge provided to Chapter 13 debtors in 1328(a) is effective only upon the completion by the debtor of all payments under the plan. Accordingly, discharge for the Nobelmans would not come for five years, assuming all plan payments were made. Further, 1328(a) is subject to exceptions to discharge including any debt provided for under Section 1322(b)(5) – long term debts. It is inescapable under the *Nobelman* undisputed facts that the Nobelmans wish to cure arrearages in their mortgage and reinstate the mortgage payments pursuant to their Chapter 13 plan. The issue then arises with regard to what benefit a possible bifurcation of the mortgage lender's claim could render to the Nobelmans if the lien would remain and the debt, both secured and unsecured, would not be discharged pursuant to 1328(a)(1) and 1322(b)(5).

The court in *Bellamy* addressed the discharge issue in a tortured manner. The Second Circuit there held that 506(a) allowed the bifurcation of the home mortgage lender's claim thus allowing the discharge of the unsecured portion of the claim and further held that 1322(b)(5) was properly used because the "stripped down" portion of the secured claim allegedly was paid pursuant to the mortgage terms. Although the *Bellamy* court does not explain it, the result in *Bellamy* is possible only because that court also, apparently, applied Section 506(d) to void the stripped down lien and eliminate the underlying debt. *Bellamy*, at 178. That is the ruse that allows the Second Circuit to avoid 1328(a)(1) *debt* discharge prohibition for long term debt treated pursuant to

1322(b)(5). The Second Circuit had to eliminate the *debt* or the 1328 discharge could not be granted. Consequently, the Second Circuit must have used 506(d) to reduce the debt, although this Court has held in *Dewsnup* that the 506(a) and 506(d) combination does not result in such debt reduction or lien voiding.

The Court should recall that in *Nobelman*, the application of 506(d) is not requested. This case is on appeal from a denial of plan confirmation. *Nobelman* is not an appeal from an adversary proceeding to determine the extent of a lien as was the case in *Bellamy*. *Bellamy*, at 178. Since there is no adversary proceeding in *Nobelman* to void the mortgage lien or allowed secured claim of the homestead mortgage lender, it is inescapable that the homestead mortgage *debt* and lien must escape discharge pursuant to 1328(a)(1). Consequently, bifurcation of the mortgage lender's secured claim pursuant to 506(a) is meaningless to the debtor in economic terms and does so much violence to Section 1322(b)(2)'s prohibition against the modification of the rights of holders of claims secured by debtors' homesteads that this Court should decline to authorize it.

A better reasoned opinion by a circuit court with regard to the interplay of 1322(b)(5) and 1328(a)(1) is the Seventh Circuit's opinion in *Chappell*.[24] The facts of *Chappell* were unusual because the Chapter 13 debtors voluntarily accelerated their mortgage to pay it in full through the plan. Consequently, the court ruled that the 1328(a)(1)

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[24] *Chappell v. Homebanc, Inc.*, 1993 W.L. 5886 (7th Cir., Jan. 14, 1993). The issue of 506(a) bifurcation was not relevant in *Chappell* because the lender was oversecured.

bar to discharge was inapplicable since the debtors were not seeking to apply 1322(b)(5) in their plan. The *Chappell* opinion discusses the "cure and maintain" option available to debtors through 1322(b)(5) applicable to home mortgages and the concomitant lack of discharge by 1328(a)(1). The debtor, with the "cure and maintain" option, exchanges the discharge for the long term pay out. The creditor is protected because it retains the lien "intact." The alternative option available to debtors, as explained by *Chappell*, is the "cram down" option which requires the debtor to pay the claim within the Chapter 13 plan. Interestingly, the Seventh Circuit in *Chappell* does not come up with a third option of not paying the claim in full, not preserving the lien but allowing the discharge.

This third option is the result in *Bellamy* which result was rejected by the Fifth Circuit in *Nobelman*. The *Bellamy* result cannot be squared with the concepts of discharge in 524 or 1328. In the general discharge section, 524, the prepetition lien passes through bankruptcy intact. In the special Chapter 13 discharge section, 1328(a)(1), the liens are also designed to pass through if the debt is not paid in the plan. The Bankruptcy Code defines "debt" at Section 101(12) as liability on a claim. What 1328(a)(1) provides is that "debt" is discharged except any "debts" provided for under Section 1322(b)(5).

Accordingly, when the Bellamys and the Nobelmans decided to use 1322(b)(5) to reinstate their mortgage loans, they elected that the mortgage *debt* not be discharged. It is important to note that 1322(b)(5) allows both unsecured and secured claims to have the "cure and maintain" option and correlative discharge bar of 1328(a)(1). Consequently, even if the Nobelmans could

"strip" their homestead mortgage lien, since the Nobelmans intend to use 1322(b)(5), both the secured and unsecured claims can be "cured and maintained" resulting in no discharge of the underlying homestead mortgage *debt*. Alternatively, if the homestead mortgage lenders secured claim is bifurcated, which Respondent denies is permissible, the *debt* is, nevertheless, not discharged and the unsecured portion remains as a nonrecourse lien on the homestead to the extent it is not paid through the plan.

Sales of assets pursuant to Section 363. Secured creditors are given two protections with regards to sales of property subject to their lien. First, a sale free of the secured creditor's debt must be for an amount sufficient to pay the secured debt, 363(f)(3), and second, the secured creditor may bid at a sale with his debt, 363(k).

Section 363(f)(3) allows sales free and clear of any interest in property only if " . . . such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property . . . ". Note that 363(f)(3) does not speak in terms of "allowed secured claims" but in terms of "liens." If the Appellants' reading of 506(a) were accurate, there would never be a need for 363(f)(3) because the debtor would always present the contract for sale as evidence of the market value of the realty and pursuant to 506(a) "strip down" the liens to authorize the sale at the purchase price and free of the lien. However, the Code is unequivocal. A sale free of a lien must be a sale at a price sufficient to pay the lien. If this Court were to accept the Appellants' reading of 506(a) and 1322, the Court would also need to be prepared to write off 363(f)(3). Respondent

Trustee asserts that there is a difference between a lien and a claim under the Code. As demonstrated in 363(f)(3) the lien controls the sale. The lien must be paid before the Bankruptcy Court will declare the sale "free and clear" of the lien. Consequently, the lien may be in an amount greater than the claim. As further support, the court should note that "lien" is a defined term in the Bankruptcy Code at Section 101(37) to mean a charge against or interest in property to secure the payment of a *debt* as opposed to a "claim."[25]

A practical application of why it is necessary for a 363(f)(3) sale to be for the full amount of all liens is seen when there is more than one title holder on the realty or obligor on the mortgage note. In that circumstance, suppose that only one of the co-obligors files bankruptcy. If there is a proposed sale in the bankruptcy for less than the full value of all liens, why should the non-debtor obtain a windfall of the reduction in debt by the property being judicially determined to be debt free without the

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[25] Since Section 506(a) does not purport to deal with debt but only with claims, 506(a) is not designed to cause the bankruptcy court to declare the property "free and clear" of liens as is contemplated in a 363(f)(3) sale. 506(a)'s purpose is to determine in the debtor's bankruptcy case the amount for distribution to an allowed secured claim without affecting the amount of the underlying debt as it relates to the mortgage lien on the realty or the indebtedness owed by non-debtor third parties. Another way of looking at it is that the debt with regard to the debtor becomes nonrecourse to the extent that the debt exceeds the court's 506(a) determined value. Nevertheless, as to non-debtor parties the debt remains undiminished (except for payment) and the lien also remains on the realty for the entire amount of the debt.

liens having been paid? What the Bankruptcy Code does instead is to require that the sales price cover all liens before the sale mortgage free can be forced upon the lienholders.[26]

Section 363(k) also gives lien holders the right to assert the full amount of the lien at the time of sale of property subject to the lien by permitting the holder of such an allowed claim to bid at the sale and set off the purchase price with the allowed claim. The "allowed claim" in the 363(k) context is the entire claim – both the previously determined 506(a) secured and unsecured portions. This reading of 363(k) is consistent with the concept that the *debt* secured by the lien is not diminished by 506(a). It is important to understand that 506(a) is a fluid concept in that the bankruptcy court may be required to have 506(a) hearings for different purposes and at different times in a bankruptcy case. If, in the 363(k) context, the realty had been previously valued under 506(a), that

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[26] It is important for this court to consider the implication of nondebtor obligors on mortgage notes. It is not infrequent that spouses will not both be debtors. Should one spouse get the windfall of the other spouse's Chapter 13 case? What if a divorce is pending and the realty is the major asset of the parties to the divorce? Should family law counsel treat each divorce to a bankruptcy to eliminate or decrease mortgages? Because of the rising costs of housing it is not unusual for children to have notes cosigned by parents or for home ownership to be joint ventured by investors. Why should non-filing investors or parents upon whose credit the original mortgage was made be given a reduction in debt because the debtor filed a bankruptcy? The Bankruptcy Code does not contemplate that the third parties get any reprieve from the debt or the mortgage lien.

previous valuation would not limit the lienholder's ability to bid the entire *debt* toward the sales price. Consequently, it is unlikely that the Nobelmans will be able to sell their home free of the mortgage debt even if the plan was confirmed.

Dismissals pursuant to Section 349. Dismissals pursuant to Section 349 demonstrate that a lien is not permanently "stripped down" by the application of Sections 506(a) and 506(d). Section 349 provides that a dismissal reinstates all liens "voided" under 506(d) or avoided under the strong arm powers of the Code.[27] In *Bellamy*, the debtor argued that the lack of equity in the realty caused the mortgage holder to have a secured claim pursuant to 506(a) only up to the value of the realty and that, presumably, pursuant to 506(d) the lien of the mortgage holder was void to the extent that the mortgage holder did not have an allowed secured claim. Obviously, the underlying lien in *Bellamy* was not gone nor void if it could be resurrected by dismissal.

In *Nobelman*, the debtors are not asserting the use of 506(d) to void the "stripped down" portion of the lien. Query, then, whether the 506(a) bifurcation of "claims" can have any voiding effect on a "lien" as requested by Appellants. It is doubtful that 506(a) by itself has any application if a bankruptcy case is dismissed.

The issue of the effect of dismissal on allegedly "stripped down" liens should be carefully considered by

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[27] Section 522(c)(2)(A)(ii) provides that exempt property is not liable for debt secured by a lien that is void pursuant to 506(d) unless the case is dismissed.

this court because of the frequent occurrence of dismissals in Chapter 13. Consider the effect of "voiding" a mortgage lien prior to all the plan payments being made. What if the debtor decided to sell the realty prior to the last plan payment but after the secured claim amount had been paid. If a hypothetical debtor paid the secured claim (determined as the market value of the home, as of the effective date of the plan) and, prior to the last plan payment, the debtor decided to sell the home for less than the prepetition mortgage debt, could the debtor give the buyers title free and clear of the lien of the mortgage holder? What if, after the sale, the debtor did not complete the plan payments and the Chapter 13 case was dismissed? Can the home mortgage lien reattach to sold property?

If the court determines that the post-confirmation sale of the realty must also comply with the home mortgage holders rights to be able to bid in the entire non-bifurcated claim at a sale pursuant to Section 363(f)(3), then the issue is, again, whether 506(a) or (d) has eliminated the lien but this time by some magic that occurs at confirmation. If confirmation is the only act a Chapter 13 debtor must take to eliminate or reduce a mortgage, the court must expect a wave of Chapter 13 bankruptcy filings for that sole purpose. Debtors will see no advantage in performing their plans if their major reason for filing is mortgage debt relief. As it is now, the courts are complaining because it appears that many debtors are staying in Chapter 13 only long enough to cure home arrearages and then are converting to Chapter 7. The Code did not build in such a blatant opportunity for abuse. Thanks to *Dewsnup* it is clear that the debtors cannot strip down a

mortgage in a Chapter 7 and this court should not allow a back door for the same result by allowing Chapter 13 strip down only as a prelude to Chapter 7.[28]

Interplay of 1322(b)(2) and 1322(b)(5) with regard to long term debt. Section 1322(b) sets out what a Chapter 13 plan "may" provide. Of particular interest is 1322(b)(2) and 1322(b)(5). These two sections have been the subject of much speculation from the early years of the Code because they relate to the treatment of long term secured creditors' claims in a Chapter 13 plan. Section 1322(b)(2) provides that a Chapter 13 plan may modify the "rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims . . . " Section 1322(b)(5) provides that a Chapter 13 plan may "notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due".

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[28] The debtor has two powerful tools in a Chapter 13 reorganization, the power to dismiss the case and the power to propose the plan. Section 1307(b) gives the debtor the right at any time to request a dismissal and the court "shall" dismiss. Section 1321 provides that only the debtor can propose a plan. The bane of Chapter 13 has been the repetitive filer that dismisses when a lift of stay is granted only to refile shortly thereafter. Since the home mortgage lender is not allowed to propose a plan and cannot prevent dismissal, an unscrupulous debtor can keep such a creditor at bay and without payment for months.

Initially, the courts debated whether 1322(b)(5) allowed the debtor to decelerate a home mortgage and make a cure of missed payments over a reasonable time during the Chapter 13 case. Those cases, for the most part, declared that such a cure was possible because the Code allowed that one invasion on the mortgage holders rights in 1322(b)(5) as specifically provided "notwithstanding paragraph (2)". A cure of arrearages was held not to be a modification violative of 1322(b)(2) which does not allow any modification of the rights of holders of a claim secured only by a security interest in the debtors homestead. See, *DiPierro v. Taddeo*, 685 F.2d 24, 27-29 (2d Cir. 1982); *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 243-246 (5th Cir. 1984).

The Appellants in the instant case appear to take the position that they are not relying on 1322(b)(5). Nevertheless, the Nobelmans expect to pay their mortgage (bifurcated and crammed down or not) beyond the length of their Chapter 13 plan. Accordingly, the Nobelmans appear to be taking the position of the *Bellamy* court that the home mortgage lien itself is reduced upon the confirmation of the Chapter 13 plan by taking the position that the secured claim is the bifurcated portion of the mortgage debt and that the stripped mortgage is "maintained" pursuant to 1322(b)(5). *Bellamy*, at 185, 186. Even if this position would allow confirmation, which Respondent-Trustee denies, it would not give the debtors a discharge as stated above.

As set out in the *Taddeo* and *Chappell* cases, the legislative history of 1322(b)(5) is clear that a reduction of payment of the mortgage debt was a modification prohibited on home mortgages but the cure of arrearages and

the reinstatement of the mortgage with the lien intact, was not a modification prohibited by 1322(b)(2) or 1322(b)(5).

Bellamy's result of an absolute reduction of the mortgage debt and lien seems irreconcilable with the plain meaning of 1322(b)(2) and 1322(b)(5) especially when dismissal pursuant to 349 would reinstate the lien, discharge of long term debts are excepted in 1328(a)(1), and confirmation in 1325(a)(5)(B) requires secured creditors to retain their liens. The Fifth Circuit's holding in *Nobelman* that 1322(b)(2) prohibited the modification of the rights of homestead mortgage lenders and that the proposed 506(a) bifurcation of the home mortgage was such an impermissible modification of rights is consistent with the overall context of the Bankruptcy Code and therefore, is a better approach than *Bellamy*.

Confirmation pursuant to 1325(a)(5) and post confirmation vesting of property pursuant to 1327(b) and 1327(c). The provisions of 1325(a)(5) relate to the requirements of confirmation for the treatment of secured claims and 1327 vests property in the debtor subject to the provisions in the plan and order of confirmation.

The court is directed by the Code, at 1325(a), that it "shall" confirm if, with regard to allowed secured claims, the creditor accepts the plan, the collateral is surrendered to the creditor, or the plan provides that the holder of the claim retain the lien and that the value of the property paid thru the plan to the secured creditor is not less than the allowed claim. By requiring that the lien be retained, the Code prevents the property from being vested at confirmation to the debtor "free and clear" of any interest

of any creditor provided for in the plan pursuant to 1327(b) and 1327(c). In short, the Nobelmans cannot shake a security interest on their home and have the plan confirmed unless the secured creditor agrees to it.[29]

The relief that the Appellants request is just not in the Code. Further, if there is to be a change of the prohibition against homestead mortgage lien and debt modification, it should be a legislative one. Last year a bill in both the Senate and House was directed at modifying the current prohibition on home mortgage lien stripping.[30] Again, Congress is purportedly, working on such a bill.

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[29] See, *Sapos v. Provident Institution of Savings*, 967 F.2d 918, 926-929 (3d Cir. 1992). In *Sapos* a Chapter 13 plan's confirmation was denied although the court approved a 506(a) cram down of the mortgage lenders debt. Nevertheless, with regard to the issue of the interplay of 1322(b)(5) and 1325, the court indicated a failure of a Chapter 13 plan to provide for payout of the 506(a) cram down value within the plan would be fatal to confirmation under 1325. *Sapos*, at 928, footnote 1.

[30] The bill would have amended Section 1322(b)(2) by adding the following language:

> " . . . [B]ut the plan may not modify a claim pursuant to Section 506 of a person holding a primary or junior security interest in real property or a manufactured home . . . that is the debtor's principal residence, except that the plan may modify the claim of a person holding such a junior security interest that was undersecured at the time the interest attached to the extent that the interest remains undersecured." S.1985, 102nd Congress, 2d Session, passed by the Senate on June 17, 1992 and referred to the House Judiciary Committee on June 18, 1992.

This bill, which would have been a legislative overruling of the *Bellamy* line of cases, would have addressed many of the issues raised by Amicus, Harold Barkley, Jr.

The change, if any, should be a legislated one precisely because it would require a review of so many sections of the Bankruptcy Code and Rules to accomplish without a total rending of the fabric of the Code.

Moreover, legislative attempts at remedy need not be at the national level alone. The result herein is not inequitable because the debtors' homestead is in the State of Texas where liens on homesteads other than purchase money liens, home improvement loans and real estate tax liens are legislatively and constitutionally prohibited. Any other state that wishes to likewise "protect" their citizens from their own bad business judgment may do so by enacting similar laws to those found in Texas.

CONCLUSION

This Court should affirm the Fifth Circuit's opinion in *Nobelman* because neither 506(a) nor 1322(b)(2) authorize a debtor to "strip down" a homestead mortgage holder's lien in a Chapter 13 plan. The recent *Dewsnup* opinion of this Court established that 506(a), by itself, or in combination with 506(d) could not be used to "strip" a mortgage lien in a chapter 7. Further, *Dewsnup* held that the lienholder's lien passed through a bankruptcy because it is an *in rem* interest that is not subject to bankruptcy discharge.

Since Section 1322(b)(2) prohibits Chapter 13 plans to modify the rights of homestead mortgage holders, and since a "strip down" of the homestead mortgage holder's lien via Section 506(a) has been determined to be unavailable to the Nobelmans, the relief that the Appellants are

seeking cannot be found in the Bankruptcy Code. Moreover, it is not consistent with the general or Chapter 13 provisions of the Code to apply Section 506(a) or 1322(b)(2) as self activating, lien voiding sections.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN and HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR AMICUS CURIAE FEDERAL HOME LOAN MORTGAGE CORPORATION IN SUPPORT OF RESPONDENT

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR AMICUS CURIAE FEDERAL HOME LOAN MORTGAGE CORPORATION IN SUPPORT OF RESPONDENT

QUESTION PRESENTED

Does Section 1322(b)(2) of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"), which provides special protection for residential mortgage lenders in cases under Chapter 13 of the Bankruptcy Code, prohibit a Chapter 13 debtor from modifying the rights of a creditor holding a claim secured only by a mortgage on debtor's principal residence by "cramming down" that creditor's secured claim to the value of the property under Section 506(a) of the

Bankruptcy Code, and then discharging the balance of the claim with unsecured debts under a Chapter 13 plan?[1]

STATEMENT OF INTEREST OF AMICUS CURIAE

Federal Home Loan Mortgage Corporation ("Freddie Mac") is a corporate instrumentality of the United States, chartered by Congress as part of its policy fostering home ownership. Its statutory mission is to foster and promote a secondary market for the purchase and sale of mortgages on residential property.[2]

Freddie Mac acts in the secondary mortgage market to increase the liquidity of mortgage investments and thereby make more capital available for home financing. Banks, savings associations and other lenders originate loans on the primary mortgage market, and then sell those loans on the secondary mortgage market to Freddie Mac. Freddie Mac, in turn, resells

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[1] "Cram-down is a term which refers to an attempt by a Chapter 13 debtor to reduce a secured claim to the value of the collateral securing the claim and to discharge the balance as an unsecured claim under the Chapter 13 plan." *Nobelman v. American Savings Bank (In re Nobelman)*, 968 F.2d 483, 486 n.5 (5th Cir. 1992).

The following example illustrates how cram-down works. Assume that a lender makes a loan in the amount of $150,000, which is secured by property having a value at the time the loan is made of $160,000. Assume the debtor files for bankruptcy protection two years after the loan is made. Assume further that during that two-year period the real estate market in the area where the property is located has declined and the value of the property has dropped to the point where at the time of the bankruptcy case, the value of the property is $100,000, although the amount owed to the creditor which is secured by the property is still $150,000. If the debtor is permitted to cram-down the creditor's claim, the creditor will be found to have a secured claim in the amount of $100,000. The balance of the claim, in the amount of $50,000, may be discharged with unsecured debts under the debtor's Chapter 13 plan, and the creditor is likely to receive little or no payment on that claim. If the value of the property subsequently appreciates above $100,000, debtor is permitted to retain this "windfall".

[2] Freddie Mac filed an amicus brief in support of Respondent with the United States Court of Appeals for the Fifth Circuit and an amicus brief in support of a petition for a writ of certiorari with this Court.

the mortgages to investors in the form of mortgage pass-through securities which represent interests in groups of mortgages. With the funds received from the resale of the mortgages, Freddie Mac purchases more mortgages from originating lenders who in turn make those funds available to home purchasers.

The secondary mortgage market thus greatly increases the supply, and reduces the cost, of home mortgage credit to America's homeowners. The smooth functioning of this market depends upon a predictable flow of principal and interest from home mortgages. Where cram-down is permitted, and borrowers are allowed unilaterally to reduce the balance of their mortgage loans, this predictability is undermined.

SUMMARY OF ARGUMENT

Chapter 13 offers a simplified and expedited means by which individual debtors having unsecured debt of less than $100,000 and secured debt of less than $350,000 can obtain adjustment of indebtedness under a Chapter 13 plan, which provides for limited payment to creditors over a period of five years or less. Section 1322 of the Bankruptcy Code sets forth the mandatory and permissive provisions of a Chapter 13 plan, and includes special protection for lenders holding a claim secured only by the debtor's principal residence. This special protection, contained in Section 1322(b)(2), provides, in relevant part, that a Chapter 13 plan may

> modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims.

11 U.S.C. § 1322(b)(2).

There is no dispute that Respondent is entitled to the protection of Section 1322(b)(2) because its claim is secured only by a security interest in debtor's principal residence. The issue before this Court, which has divided circuit courts, bankruptcy courts and district courts throughout the country, is the extent of such

protection. Petitioners assert that under Section 506(a) of the Bankruptcy Code they may modify Respondent's claim by reducing the amount of the secured claim to the value of the collateral and discharging the portion of the claim which exceeds such value with other unsecured claims.[3] Essentially, Petitioners want to limit the protection of Section 1322(b)(2) to the amount of the secured claim following cram-down under Section 506(a), leaving the unsecured portion of the claim free to be modified. This would leave the lender with a lien up to the value of the property and would discharge the lien on the unsecured portion of the lender's claim.[4]

Petitioners arrive at this result by suggesting that Section 1322(b)(2) must be read with an eye towards life in the real

[3] Section 506(a) provides that a claim secured by a lien on property is a secured claim to the extent of the value of the property securing it, and is an unsecured claim to the extent the claim exceeds such value.

[4] Regardless of whether the unsecured portion may be modified, courts universally agree that a Chapter 13 debtor may not alter the amount or the timing of the payments required to be made under the mortgage, or change the mortgage interest rate. Any other conclusion would render the protection of Section 1322(b)(2) completely meaningless. *See Bellamy v. Federal Home Loan Mortgage Corp.*, 962 F.2d 176, 184-85 (2d Cir. 1992). *See also In re Honett*, 116 B.R. 495, 497 (Bankr. E.D. Tex. 1990) (despite "the allowance of the bifurcation of a Chapter 13 creditor's secured claim . . . the interest rate or monthly payment amount cannot be modified"); *In re Hayes*, 111 B.R. 924, 926 (Bankr. D. Or. 1990) (the reduction of the monthly payment to reflect the lower balance to be paid after cram-down is an impermissible modification); *In re Hyden*, 110 B.R. 46, 50 (Bankr. W.D. Okla. 1990) ("Even when the claim is bifurcated under § 506(a) . . . the provisions of § 1322(b)(5) protect the creditor at least to the extent that they require that the default, i.e., the arrearages, be cured in a reasonable time and that regular payments be maintained, albeit for a shorter period of time."); *In re Demoff*, 109 B.R. 902, 920 (Bankr. N.D. Ind. 1989) ("The size and timing of the installment payments will not be altered and thus the scheduled amount of the monthly contract payment will remain the same, as will the interest rate."); *In re Ross*, 107 B.R. 759, 762 (Bankr. W.D. Okla. 1989) ("Thus, the amount of the payments required to be made under the governing documents may not be changed, although the result may be that the obligation secured by the mortgage may be paid in full much more rapidly."). Indeed, Petitioners acknowledge the prohibition on such modifications. *See* Petitioners' Brief at p. 7.

world of real estate and mortgage foreclosure. Yet it is they who ignore reality. Petitioners mistakenly believe that cram-down merely replicates a foreclosure sale at which "the lienholder will receive something approximating the fair market value [of the collateral], with the balance of its claim becoming an unsecured deficiency claim". *See* Petitioners' Brief at p. 6. In point of fact, rather than mirror foreclosure, cram-down destroys the essence of a mortgagee's rights in a foreclosure.

Faced with an undersecured loan, a mortgagee can credit-bid at the foreclosure sale and become the owner of the property.[5] The mortgagee then holds the hope that the real estate market will improve and at least some of its deficiency can be recovered. This is the real world of bank examiners and loan officers — deciding when to and when not to credit-bid *i.e.*, on which properties should they play the market hoping for a turnaround and on which should they simply take what they can get and write off the rest. In fact, typically the lender will credit-bid its claim and become the owner of the property. This is the real world that cram-down eliminates by taking away this option from the mortgagee.

Cram-down fails to replicate foreclosure in two other ways. First, in a cram-down, the mortgagee only has a lien up to the market value of the property and must pray that the debtor, who previously could not make monthly principal and interest payments, will now faithfully mail a check every month for the very amount he or she previously could not afford. Thus, in cram-down the mortgagee continues to bear the risk of a default under debtor's reorganization plan. If such default occurs, the mortgagee will incur, for a second time, the expense and delay of instituting another foreclosure action and possibly the expense and delay of a second bankruptcy proceeding. Indeed, multiple bankruptcy filings by the same debtor are quite common. By contrast, in foreclosure, if someone does buy the property for its market value, the mortgagee receives that amount in a

[5] Credit-bidding is the process by which the secured creditor can bid at the sale up to the full amount of its claim. *See* 11 U.S.C. § 363(k) (providing for the secured creditor to offset its claim against the purchase price of the property).

lump sum cash payment and has no further risk of a default by debtor.

Second, private mortgage insurance programs require a lender to foreclose before they will pay for the lender's loss. Insurance will not cover the lender's loss following cram-down, but will only guarantee payment of the reduced balance. Thus, in foreclosure insurance protects the difference between the debt and the value of the property; in cram-down it does not. Cram-down and foreclosure are worlds apart.

Petitioners go on to say that cram-down benefits the debtor by making refinancing a "viable option". *See* Petitioners' Brief at p. 8. To think that lenders will provide market rate financing to a person fresh out of bankruptcy for the full market value of the property (*i.e.* 100% loan-to-value) simply is to fantasize.

Petitioners jump from these false "practical aspects" to the conclusion that Section 1322(b)(2) must be read to permit cram-down based on the assumption that Section 506(a) of the Bankruptcy Code limits Section 1322's express protection. But that is the very question before this Court, not the answer. Even if Petitioners "practical aspects" were true, they would be largely irrelevant to what is a question of statutory interpretation. The question is whether the special statutory protection for residential mortgage lenders protects the mortgagee's entire claim or only the amount of such claim up to the value of the collateral. There can be only one answer: the statute expressly precludes modification of the rights of holders of a claim secured by residential property. The lender's entire claim is secured by the collateral and thus cram-down would modify the lender's rights impermissibly.

The United States Court of Appeals for the Fifth Circuit agreed, rejecting Petitioners' arguments, as well as the Circuit Court decisions supporting Petitioners. *See Bellamy v. Federal Home Loan Mortgage Corp. (In re Bellamy)*, 962 F.2d 176 (2d Cir. 1992); *Eastland Mortgage Co. v. Hart (In re Hart)*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990); *Hougland v. Lomas & Nettleton Co. (In re Hougland)*, 886 F.2d 1182 (9th Cir. 1989). The Fifth Circuit recognized, as many bankruptcy courts and district courts have, that the express language and the legislative history of Section 1322(b)(2) mandate the conclusion that cram-down of a residential mortgage lender's claim violates the Bankruptcy Code. *See Nobelman*, 968 F.2d 483 (5th Cir. 1992).[6] Further support for the Fifth Circuit's decision can be found in this Court's recent decision in *Dewsnup v. Timm*, ____U.S.____, 112 S.Ct. 773 (1992), through an analysis of the untenable effects of permitting cram-down on the overall structure of Chapter 13 and the primary and secondary mortgage markets, and by consideration of Congressional policy favoring home ownership.

Thus, the conflict among the Circuit Courts of Appeals should be resolved by an affirmance of the Fifth Circuit's decision in *Nobelman*, making crystal clear that Chapter 13 debtors may not cram-down a residential mortgage lender's claim to the value of the collateral securing such claim. The special protection afforded residential mortgage lenders in Section 1322(b)(2) of the Bankruptcy Code requires that such mortgage debt be paid in full according to its original terms.

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[6] Lower court decisions which had previously reached the same conclusion as the Fifth Circuit in *Nobelman* include: *In re Russell*, 93 B.R. 703 (D.N.D. 1988); *In re Mitchell*, 125 B.R. 5 (Bankr. D.N.H. 1991); *In re Etchin*, 128 B.R. 662 (Bankr. W.D. Wis. 1991); *In re Wilks*, 123 B.R. 555 (Bankr. W.D. Tex. 1991); *In re Boullion*, 123 B.R. 549 (Bankr. W.D. Tex. 1990); *In re Chavez*, 117 B.R. 733 (Bankr. S.D. Fla. 1990); *In re Sauber*, 115 B.R. 197 (Bankr. D. Minn. 1990); *In re Schum*, 112 B.R. 159 (Bankr. N.D. Tex. 1990); *In re Kaczmarczyk*, 107 B.R. 200 (Bankr. D. Neb. 1989); and *In re Catlin*, 81 B.R. 522 (Bankr. D. Minn. 1987).

ARGUMENT

I

THE PLAIN MEANING OF SECTION 1322(b)(2) PRECLUDES A DEBTOR FROM CRAMMING DOWN A CLAIM SECURED ONLY BY THE DEBTOR'S PRINCIPAL RESIDENCE

"In determining the meaning of any statute, the words of the statute are 'the primary, and ordinarily the most reliable, source of interpreting' its meaning." *In re Chavez*, 117 B.R. 733, 735 (Bankr. S.D. Fla. 1990) (*quoting Watt v. Alaska*, 451 U.S. 259, 266 n.9 (1981)). *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) ("The plain meaning of legislation should be conclusive, except in 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.' ") (*quoting Griffin v. Ocean Contractors, Inc.*, 458 U.S. 564, 571 (1982)).

A. *The Express Language of Section 1322(b)(2) Protects From Modification the "Rights of Holders" of Secured Claims, Not Only the Secured Portion of the Creditor's Claim*

Section 1322(b)(2) permits a Chapter 13 plan to "modify the *rights* of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2) (emphasis added). "Rights" is the object of "modify" in the phrase that precedes the critical exception to permissible modifications at issue in this case.

Indeed, the Fifth Circuit explicitly recognized the proper reading of Section 1322(b)(2) stating,

> section 1322(b)(2) describes its subject matter as the modification of "the *rights of holders* of" claims, not as the modification of *claims* as such; thus the section can be properly read as *excepting* from its reach

> modification of "*the rights of holders of* . . . a claim secured only by a security interest in real property that is the debtor's principal residence. . . ." Therefore, even if the entirety of such a claim is not a secured claim (as per Section 506(a)), the rights of a holder of such a claim may not be modified under section 1322(b)(2).

Nobelman, 968 F.2d at 488 (emphasis in original). *See also In re Lee*, 137 B.R. 285, 287 (Bankr. E.D. Wis. 1991) (under Section 1322(b)(2) "it is the 'rights of holders' and not the 'claims' alone which cannot be modified") (citation omitted); *In re Etchin*, 128 B.R. 662, 668 (Bankr. W.D. Wis. 1991) (Section 1322(b)(2) protects all of the various rights of undersecured mortgage holders, not just the secured portion of the claim).

Petitioners seek to avoid the plain meaning of Section 1322(b)(2) stating that by virtue of Section 506(a), the Bankruptcy Code has "reduced the rights of the holder" of a residential mortgage lien. *See* Petitioners' brief at pp. 11-12. By presuming that Section 506(a) limits the protections of Section 1322(b)(2) without examining the latter's express language, Petitioners simply beg the question of to what extent Section 1322(b)(2) protects a residential mortgage lender's claim.

Section 1322(b)(2) does not state, as Petitioners claim, that it is only a creditor's *secured claim* which may not be modified. Rather, by its express terms the statute provides that a residential mortgage holder's *rights* may not be modified by a Chapter 13 debtor. It necessarily follows that a Chapter 13 debtor may not cram-down such lender's claim to the value of the collateral, but must pay the entire indebtedness in accordance with its original terms. Anything less would be a modification of the rights of the residential mortgage holder in contravention of the express terms of Section 1322(b)(2) of the Bankruptcy Code.[7]

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[7] The Second Circuit missed the mark by stating that "[t]he real question is whether the 'rights' to which § 1322(b)(2) refers include the mortgagee's rights concerning its *claim* or its rights with respect to its *secured claim*."

(Footnote continued)

B. *The "Other-Than" Clause of Section 1322(b)(2) Expressly Precludes Cram-down of a Residential Mortgage Lender's Claim*

Assuming, *arguendo*, that Section 1322(b)(2) is *not* interpreted to prohibit modification of the *rights* of residential mortgage holders, but rather to address the modification of *claims* of residential mortgage holders, the same result must follow. This is so because the "other-than" clause of Section 1322(b)(2) demonstrates that a residential mortgage holder's claim is fully protected from modification.

Section 1322(b)(2) provides, in relevant part, that a Chapter 13 plan may

> modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence.

The plain and obvious meaning of the phrase, "other than a claim secured only by a security interest in real property that is the debtor's principal residence", is that a *claim* for which the only security held by the lender is a home mortgage cannot be modified. "Claim" is expressly defined in the Bankruptcy Code as *any* "right to payment, *whether or not such right is . . . secured or unsecured*." 11 U.S.C. § 101(5)(A) (emphasis added). Thus, it is apparent from the language of the statute that

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Bellamy, 962 F.2d at 179 (emphasis in original). Concluding that treatment under the Bankruptcy Code generally turns on whether a *claim* is secured or unsecured, rather than the status of the *creditor* as secured or unsecured, the Second Circuit concluded that the rights which cannot be modified are those of the secured claim, not the secured creditor. *Id.* at 179-181.

The critical flaw in this analysis is that the express language of Section 1322(b)(2) protects the "*rights of holders* of secured claims" and no basis exists for imposing a limit on this clear statutory provision. While other provisions of the Bankruptcy Code may focus on the status of a claim rather than the status of the creditor, Section 1322(b)(2) by its express terms is not so limited.

1322(b)(2) protects from modification both the secured *and* any unsecured portion of a residential mortgage holder's claim.[8]

Indeed, Section 506(a), the very provision which Petitioners rely on, distinguishes between a "claim secured" and a "secured claim". As one bankruptcy court recently stated,

> Section 506(a) declares that an "allowed claim of *a creditor secured by* a lien on property . . . is *a secured claim* to the extent of the value of such creditor's interest in the estate's interest in such property." *Thus, the "claim of a creditor secured by a lien on property" is not necessarily a "secured claim."* Whether it is or not will depend on the value of the creditor's interest in the estate's interest in the property. *But whether or not the claim is a "secured claim", it is still a "claim . . . secured by a lien on property."*

In re Strober, 136 B.R. 614, 620 (Bankr. E.D.N.Y. 1992) (*quoting* 11 U.S.C. § 506(a)) (emphasis added in part).

By limiting a residential mortgage lender's protection to the secured portion of its claim, the courts permitting cram-down impose a limitation on Section 1322(b)(2) in complete disregard of this critical difference between a "secured claim" and a "claim secured". Even if the mortgage exceeds the value of the property, the claim is still secured only by a residential mortgage despite the fact that only a portion of the claim is a "secured" claim as defined in Section 506(a). *See id.* at 619. *Cf. Dewsnup*, ____U.S.____, 112 S.Ct. at 781 (Scalia, J., *dissenting*) (majority held that for purposes of Section 506(d) the phrase "secured claim" simply constitutes a claim backed by a security interest in property regardless of whether the value of the property suffices to cover the claim).

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[8] The conclusion that the word "claim" in the "other-than" clause must be read to include any unsecured deficiency amount held by a residential mortgage lender is reinforced by the fact that the language preceding that clause refers to "secured claims," while the "other-than" clause simply refers to "a claim." This juxtaposition underscores the drafters' intent to maintain the independence of the "other-than" clause from the preceding "secured claims" language. *See In re Etchin*, 128 B.R. at 667-68.

Thus, the restriction on modification provided for in the "other-than" clause of Section 1322(b)(2) is not limited to the portion of the creditor's claim which is secured, but extends to the entire claim, secured or unsecured, provided that the security consists only of an interest in debtor's principal residence. Accordingly, the Fifth Circuit's decision must be affirmed.[9]

C. *The Specific Provision of Section 1322(b)(2) Must Override the General Provision of Section 506(a) if they Conflict*

When correctly interpreted in the manner outlined above, Section 1322(b)(2) is not inconsistent with Section 506(a). Section 506(a) does not purport to determine a creditor's right to receive payment of its claim or the extent to which a creditor's rights may be modified under a plan. *See Bellamy*, 962 F.2d at 180; *In re Simpkins*, 16 B.R. 956, 965 (Bankr. E.D. Tenn. 1982). These matters are specifically provided for elsewhere in the Bankruptcy Code, and specifically in Section 1322(b)(2) for Chapter 13.

Even if Sections 1322(b)(2) and 506(a) were found by this Court to be in conflict, it is a basic tenet of statutory construction that "[g]eneral language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment." *D. Ginsberg & Sons v. Popkin*, 285 U.S. 204, 208 (1932) (citation omitted); *see Gozlon-Peretz v. United States*, 498 U.S. 395, 111 S.Ct. 840, 848 (1991). *See also Nobelman*, 968 F.2d at 488 ("[w]e accordingly hold that the specific language of section 1322(b)(2) prevails over the general language of section 506(a)").

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[9] The Second Circuit rejected this argument out of hand, stating that under the "rule of the last antecedent" the other-than clause should be read to refer to the words immediately preceding it—"secured claims". *Bellamy*, 962 F.2d at 180-81. *See also Lomas Mortgage v. Wiese*, 980 F.2d 1279 (9th Cir. 1992). This simply ignores the full "other-than" clause with its reference to a "claim" and the all-encompassing definition of the word "claim" that is applicable throughout the Bankruptcy Code, including in Chapter 13. 11 U.S.C. § 101(5)(A); *see Etchin*, 128 B.R. at 668.

In sum, the only interpretation of Section 1322(b)(2) which is grammatically comprehensible and consistent with the other provisions of the Bankruptcy Code is that Chapter 13 debtors are precluded from cramming down residential mortgage debt. Thus, the decision of the Fifth Circuit was correct and should be affirmed by this Court.

II

THE LEGISLATIVE HISTORY OF SECTION 1322(b)(2) CONFIRMS THAT CRAM-DOWN OF RESIDENTIAL MORTGAGE DEBT IS PROHIBITED

The Fifth Circuit's interpretation of Section 1322(b)(2) which protects the right of a residential mortgage lender to full payment in accordance with the original terms of its mortgage and note also is supported by the legislative history of the statute. This is as apparent from the evolution of Section 1322(b)(2) as from its language.

Under Chapter XIII of the Bankruptcy Act of 1898, the statutory predecessor of Chapter 13, an individual's reorganization plan could not modify the rights of *any* creditor holding a claim secured by real property. As first proposed, the House version of the Bankruptcy Code completely eliminated this rule, setting no limits on the ability of an individual to modify secured claims through a Chapter 13 plan. *See* H.R. 8200, 95th Cong., 1st Sess. Sec. 1322(b)(2) (1977). The Senate version, on the other hand, preserved the protection afforded under Chapter XIII to all creditors secured by real estate. *See* S. 2266, 95th Cong., 1st Sess. Sec. 1322(b)(2) (1977).

At Senate hearings in the 95th Congress, the concerns of residential mortgage lenders about the impact of the House version were voiced by Edward J. Kulik, Senior Vice President, Real Estate Division, Massachusetts Mutual Life Insurance Co.

> When a plan is "crammed-down" . . . the secured creditor is paid only the depressed "appraised value" of the property—even though it is substantially less

> than the principal balance of the debt – the secured creditor loses any possibility of recovering the full debt if the real estate market returns to more normal conditions. Hence, the creditor is, in substantial part, denied its security and its contract rights.

Hearings Before the Subcommittee on Improvements of the Judicial Machinery of the Committee on the Judiciary, United States Senate, 95th Cong., 1st Sess. (1977), p. 709.

Mr. Kulik emphasized that allowing cram-down of residential mortgage debt to occur would have a particularly severe adverse effect on the availability of home mortgage funding. As Mr. Kulik explained allowing cram-down "may cause residential mortgage lenders to be extraordinarily conservative in making loans in cases where the general financial resources of the individual borrower are not particularly strong." *Id.* at p. 714. To avoid this result, he proposed that the legislation be modified to protect the right to payment of the *entire amount* secured by a residential mortgage, stating

> [s]erious consideration should be given to modifying both bills so that, at the least: *one, a mortgage on real property other than investment property may not be modified.*

Id. (emphasis added).

It is against this background that Section 1322(b)(2)'s compromise language, limiting the broad anti-modification protection of the former Bankruptcy Act to holders of claims secured by residential mortgages, must be read. Indeed, the legislative history of Section 1322(b)(2) was carefully analyzed by the United States Court of Appeals for the Fifth Circuit which concluded that the compromise language was intended to protect residential mortgage lenders from modification, including cram-down.

> With regard to § 1322(b)(2), the Senate receded from its position that no 'modification' was to be permitted

> of *any* mortgage secured by real estate; it instead agreed to a provision that modification was to be barred *only* as to a claim 'secured only by a security interest in real property *that is the debtor's principal residence.*' This limited bar was apparently in response to perceptions, or to suggestions advanced in the legislative hearings, *see* note 13 *supra* [citing Mr. Kulik's testimony] that home-mortgagor [sic] lenders, performing a valuable social service through their loans, needed special protection against modification thereof (*i.e.*, reducing installment payments, *secured valuations*, etc.).

Grubbs v. Houston First American Savings Association, 730 F.2d 236, 246 (5th Cir. 1984) (emphasis added in part).

It is apparent from the legislative history that the intent of Section 1322(b)(2) is to preserve the availability of residential mortgage funding for individuals of modest means by prohibiting Chapter 13 debtors from cramming down the claims of residential mortgage lenders. This is precisely the modification of rights that residential real estate lenders expressed concern about in hearings held shortly before the final enactment of the Bankruptcy Code, and precisely the modification that Section 1322(b)(2) prohibits. *See Nobelman*, 968 F.2d at 489 (the legislative history envisions an intent not to permit any modification on a claim secured by the debtor's principal residence and thus Section 506(a) cannot be used to bifurcate the claim and vitiate the protection of Section 1322(b)(2)).[9]

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[9] To the limited extent that the Third Circuit analyzed the legislative history of Section 1322(b)(2), it focused on the report of the Commission on Bankruptcy Laws of the United States, which was issued at the beginning of the legislative process, years prior to the final enactment. *Wilson*, 895 F.2d at 127-28. The Second, Ninth and Tenth Circuits concluded that, while the legislative history evidences an intent to protect home mortgage lenders, it does not reveal the extent of this protection and thus the legislative history is not inconsistent with the conclusion that only the secured portion of the creditor's claim cannot

(Footnote continued)

III

THIS COURT'S DECISION IN *DEWSNUP V. TIMM* SUPPORTS THE FIFTH CIRCUIT'S INTERPRETATION OF SECTION 1322(b)(2) OF THE BANKRUPTCY CODE

In *Dewsnup v. Timm*, ____U.S.____, 112 S.Ct. 773 (1992), this Court held that a Chapter 7 debtor may not cram-down a creditor's lien on real property to the value of the collateral when that value is less than the amount of the claim secured by the lien and avoid the lien with respect to the amount exceeding the value of the collateral. While this decision was rendered in the context of Chapter 7, "it is almost impossible to reconcile the decision's rationale with any different result in Chapter 13." *In re Strober*, 136 B.R. at 615-16.

In *Dewsnup*, debtor asserted that under Section 506(d) of the Bankruptcy Code the creditor only retains a lien up to the value of the property securing the debt and the lien for the amount above the value of the property is void.[11] Recognizing the ambiguous nature of the term "secured claim" in Section 506(d), this Court rejected debtor's argument, focusing on the pragmatic impact of debtor's position.

> The practical effect of petitioner's argument is to freeze the creditor's secured interest at the judicially determined valuation. By this approach, the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale. The increase would accrue to the benefit of the debtor, a result some the parties describe as a "windfall."

be modified. *Bellamy*, 962 F.2d at 182; *Hart*, 923 F.2d at 1415; *Hougland*, 886 F.2d at 1185. These courts overlooked the testimony before the Senate quoted above which highlighted the importance of preventing cram-down of residential mortgage lenders in Chapter 13. This testimony leads to the conclusion, which was reached by the Fifth Circuit, that protection of the residential mortgage lender's entire claim is mandated by Section 1322(b)(2).

[11] Section 506(d) states, in relevant part, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."

> We think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee. . . .Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain.

Dewsnup, ____U.S.____, 112 S.Ct. at 778.

The same analysis and conclusion apply here. Allowing cram-down of residential mortgage debt in Chapter 13 cases will yield the precise result this Court condemned in *Dewsnup* — a windfall to the debtor which properly should flow to the mortgage lender in the amount of any increase in the value of the property. *See* Section IV(A) *infra*. Further, even less authority exists for permitting bifurcation and cram-down in this case than existed in *Dewsnup* because Chapter 13 contains an explicit prohibition against modification of " 'a claim secured only by a security interest in real property that is the debtor's principal residence'. " *Strober*, 136 B.R. at 619 (*quoting*, 11 U.S.C. § 1322 (b)(2)). It simply defies logic to permit a Chapter 13 debtor to bifurcate and cram-down a residential mortgage holder's claim while a Chapter 7 debtor has no such right.[12]

Indeed, since the *Dewsnup* decision, the Fifth Circuit as well as some bankruptcy courts have concluded that *Dewsnup* provides further support for the conclusion that Chapter 13 debtors may not cram-down the claim of a residential mortgage lender. *See Nobelman*, 968 F.2d at 487 ("The Supreme Court's recent decision in *Dewsnup* lends support to this view that bifurcation is impermissible.") (citation omitted); *Strober*, 136 B.R.

[12] Nor could a Chapter 11 debtor cram-down a mortgage as Petitioners seek to do in Chapter 13. Under Section 1111(b) of the Bankruptcy Code, a secured creditor may elect to have the lien securing its claim secure the entire amount of the claim. By making this so-called 1111(b) election, the creditor receives the benefit of appreciation in the collateral up to the full amount of its claim secured by the collateral.

at 618 (decisions allowing cram-down of a residential mortgage holder's claim in Chapter 13 cases have been "weakened, if not demolished, by *Dewsnup*"); *In re Barnes*, 146 B.R. 854, 855 (Bankr. W.D. Okla. 1992) (based upon *Dewsnup* decision, adopting *Nobelman* analysis despite Tenth Circuit decision in *Hart*); *In re Doss*, 143 B.R. 952, 953-54 (Bankr. E.D. Okla. 1992) (rejecting bifurcation based upon express language of Section 1322(b)(2) as well as this Court's decision in *Dewsnup*); *In re Davidoff*, 136 B.R. 567, 569 (Bankr. M.D. Fla. 1992) (*Dewsnup* supports conclusion that bifurcation of a residential mortgage lender's claim is not permitted under Section 1322(b)(2)).[13]

[13] The Second Circuit concluded that *Dewsnup* was inapposite because its analysis was limited to Section 506(d) and did not extend to Chapter 13. *Bellamy*, 962 F.2d at 182-84. The *Dewsnup* decision post-dated the briefing and oral argument in *Bellamy*, and the Second Circuit denied Freddie Mac's petition for rehearing and rehearing *en banc*. Therefore Freddie Mac was not provided an opportunity to argue the impact of *Dewsnup* on Chapter 13.

The Third and Ninth Circuits have reaffirmed their cram-down decisions following *Dewsnup* based upon the lead of the Second Circuit. *See Lomas Mortgage v. Wiese*, 980 F.2d 1279, 1282 (9th Cir. 1992) (summarily dismissing impact of *Dewsnup* based on *Bellamy*, stating "[n]owhere does *Dewsnup* suggest that its discussion of 'lien stripping' has any impact on the bifurcation of secured claims from unsecured claims for purposes of Chapter 13"); *Sapos v. Provident Institution of Savings*, 967 F.2d 918, 921 (3d Cir. 1992) (relying on *Bellamy*, the court concluded that "the holding of *Dewsnup* is limited to chapter 7 liquidations only and does not reach reorganization under chapter 13").

These decisions fail to recognize the unjustifiable windfall to the debtor which was the impetus for this Court's decision in *Dewsnup* and which similarly flows from allowing cram-down in Chapter 13. *See* Argument IV(A), *infra*.

IV

CRAM-DOWN OF RESIDENTIAL MORTGAGE DEBT IS AT ODDS WITH THE STATUTORY SCHEME OF CHAPTER 13 AND IS UNFAIR AND UNWORKABLE

While the express language of Section 1322(b)(2) and its legislative history clearly demonstrate that the Fifth Circuit's decision was correct, this Court's holistic approach to statutory construction outlined in *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988) provides further support for the conclusion that a residential mortgage lender's entire claim is protected from modification.

> Statutory construction, however, is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme – because the same terminology is used elsewhere in a context that makes its meaning clear. . . or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.

Id. at 371 (citation omitted).

The meaning of Section 1322(b)(2) is indeed clarified when it is viewed in the context of the statutory scheme of Chapter 13. This is so for precisely the reason stated by this Court in *Timbers* – because only the interpretation of Section 1322(b)(2) to forbid cram-down of residential real estate mortgages "produces a substantive effect that is compatible with the rest of the law". *Id.* (citation omitted). This can be seen from the fact that the interpretation of Section 1322(b)(2) urged by Petitioners produces a number of results which are inconsistent – indeed, at odds with – the statutory scheme. Consideration of these results also highlights the deficiencies of the decisions of the Second, Third, Ninth and Tenth Circuits allowing cram-down.[14]

[14] The Third, Ninth and Tenth Circuits did not address the untenable effects of cram-down on the structure of Chapter 13, the primary and secondary

(Footnote continued)

A. *Cram-down Provides a Windfall to Chapter 13 Debtors*

Cram-down of residential mortgage debt in Chapter 13 cases provides a windfall to Chapter 13 debtors in times of instability in real estate markets because it allows them to reduce their mortgage debt to the temporarily depressed market value of the property and then to reap the benefit of the appreciation in the value of the property when the market recovers. This is precisely the windfall that this Court condemned in *Dewsnup*, and which, under that decision, cannot occur in a case under Chapter 7 of the Bankruptcy Code.[15]

Nor could such a windfall occur if the property were sold, either in the bankruptcy case or outside bankruptcy, or if the property were treated under a Chapter 11 plan. If the property were sold at a bankruptcy or foreclosure sale, the creditor would have the right to acquire the property by credit-bidding its claim, and then to realize the benefit of future appreciation by holding the property and selling it when the market recovers.[16]

Similarly, under a Chapter 11 plan, a secured creditor may elect under Section 1111(b) of the Bankruptcy Code to have the lien securing its claim secure the entire amount of its claim. By so electing, the creditor may receive the benefit of appreciation in the value of the collateral up to the full amount of its claim,

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mortgage markets or Congressional policy favoring home ownership. The Second Circuit summarily dismissed these practical implications with little analysis, stating, "[o]nce it is understood that the 'rights' which § 1322(b)(2) protects are limited to the secured claim (as per § 506(a)), Federal Home and amici's alternative arguments can be readily resolved." *Bellamy*, 962 F.2d at 184.

[15] Petitioners acknowledge that cram-down may indeed result in such windfall for debtors. *See* Petitioners' Brief at pp. 8-9.

[16] Thus Petitioners' assertion that cram-down has the same effect on the residential mortgage lender (Petitioners' Brief at p. 6) simply ignores this right to credit-bid which is eliminated if cram-down is permitted. *See* p. 5 *supra*.

even if the collateral is worth less than the amount of the claim at the time the plan is confirmed.

B. *Cram-down Would Result in Home Mortgage Lenders Receiving Worse Treatment Under Chapter 13 Than Other Secured Creditors*

Cram-down of residential mortgage debt would also create the paradoxical result, surely at odds with the undeniable intent of Section 1322(b)(2) to protect residential mortgage lenders, of subjecting them to worse treatment than other secured creditors in times of rising interest rates. This is so because under Section 1325(a)(5)(B)(ii), a creditor receiving payment over time of a secured claim under a Chapter 13 plan is entitled to receive interest at a market rate which compensates the creditor for not receiving payment of the full amount of its secured claim upon confirmation of the Chapter 13 plan.

But Section 1322(b)(2), by prohibiting modification of the rights of a creditor whose claim is secured by a lien on the debtor's principal residence, would restrict a residential mortgage lender to the contract rate even if it is less than the market rate. *See In re Terry*, 780 F.2d 894 (11th Cir. 1985); *In re Brown*, 91 B.R. 19 (Bankr. E.D. Va. 1988); *In re Simpkins*, 16 B.R. 956 (Bankr. E.D. Tenn. 1982). *See also* n.4 *supra*. Thus, when the residential mortgage lender's claim is crammed down to the value of the collateral, and a below-market contract interest rate is applied to this reduced claim, the result is that the residential mortgage lender receives significantly less favorable treatment than a secured creditor who is *not* entitled to the special protection of Section 1322(b)(2).

An example will help illustrate the point. A 30-year $200,000 mortgage at an interest rate of 6% requires monthly payments of $1,199.11. If the value of the property drops to $100,000 but interest rates rise to 15%, the mortgagor may file for bankruptcy under Chapter 13, and if Petitioners' view were adopted, seek to cram-down the mortgagee's lien to $100,000, but continue the $1,199.11 monthly payment and 6% interest rate. It would

then take 108 payments to satisfy the "new" $100,000 debt in full. However, the present value of 108 payments of $1,199.11 with interest rates at 15% is only $70,814, not $100,000. Thus, the residential mortgage lender does not receive the present value of its claim while any other creditor would under Section 1325. Surely this absurd result flies in the face of the meaning of the statute and the undisputed intent of Congress to benefit and protect residential mortgage lenders.[17]

C. *Instead of Assisting Chapter 13 Debtors, Cram-down Would Result in Their Being Required to Pay the Entire Amount of the Secured Claim in Five Years or Less Under Section 1322(c)*

The incorrectness of Petitioners' interpretation of Section 1322(b)(2) is further underscored by the fact that if they were permitted to cram-down their home mortgage lenders, they would be required to pay the entire amount of the secured claim – *i.e.*, the value of the collateral – in five years or less pursuant to Section 1322(c) of the Bankruptcy Code, which states that

[17] Allowing cram-down of residential mortgage claims without providing the lender with payment of the present value of the collateral may result in an unconstitutional "taking" of the creditor's property without just compensation. *See Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935) (bankruptcy statute violated Takings Clause because debtor could purchase property for less than fair market value and present value of the payments to the creditor was below value of the property). Indeed, this Court relied on *Radford* in reaching its decision in *Dewsnup*. *See Dewsnup*, ____U.S.____, 112 S.Ct. at 779.

Thus, to avoid a potential constitutional infirmity Petitioners' interpretation of Section 1322(b)(2) must be rejected under the "cardinal principal that [the Supreme Court] will first ascertain whether a construction of the statute is fairly possible by which the constitutional question may be avoided." *United States v. Security Industrial Bank*, 459 U.S. 70, 78 (1982) (citation and quotation omitted). *See also Edward J. DeBartolo Corp. v. Florida Gulf Coast Building & Construction Trades Council*, 485 U.S. 568, 575 (1988) (it is a well-settled axiom of statutory interpretation that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the [Supreme] Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.") (citations omitted).

> [t]he plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.

11 U.S.C. § 1322(c).

Where cram-down is available (*i.e.*, where the creditor's claim is *not* secured only by the debtor's principal residence and is therefore not entitled to Section 1322(b)(2) protection), Section 1322 gives the debtor two choices in the treatment of secured claims. The debtor may cure any default and reinstate the obligation pursuant to Section 1322(b)(5), paying it in accordance with its original terms. Alternatively, the debtor may elect to cram-down the secured obligation thereby reducing it to the value of the underlying collateral. If this latter option is chosen, however, payment of the entire amount of the secured claim must be made under the plan within the five year period.

The Fourth Circuit explained the debtor's alternatives in *Landmark Financial Services v. Hall*, 918 F.2d 1150 (4th Cir. 1990).

> To summarize, the principal components of a § 1325 cram-down are retention of the lien by the secured creditor and provision for the payment, during the life of the plan, i.e. 3-5 years, of the full value of the secured claim.... A cure essentially involves (1) satisfying any arrearages currently due, within a reasonable time, and (2) maintaining regular mortgage payments as they come due.... Whereas the cram-down route compensates the secured creditor with the present value of his collateral, the cure route reinstates the initial agreement which is the basis of the claim regardless of the value of the collateral.

Id. at 1154. *See also In re Scott*, 121 B.R. 605, 608 (Bankr. E.D. Okla. 1990) ("If a debtor desires to extend a creditor's payment beyond the term of the Plan, the only avenue available is to cure any default due under the Plan and resume the payments under

the original mortgage. This does not incorporate the use of § 1322(b)(2) in any fashion."); *In re Foster*, 61 B.R. 492, 494 (Bankr. N.D. Ind. 1986) ("absent the cure situation addressed by § 1322(b)(5), no payments beyond the term of the plan can be involuntarily imposed on a creditor"). In short, the debtor can either cram-down the claim and pay the secured portion over the life of the plan or cure the arrears and reinstate the long-term debt according to its original terms.[18]

Thus, cram-down of residential mortgage debt, far from assisting Chapter 13 debtors, would have the effect of accelerating residential mortgages, which are generally long-term obligations, converting them into obligations which must be paid under the plan within five years. This absurd result makes it obvious that Section 1322(b)(2) should not be interpreted to allow cram-down of residential mortgage debt, because such interpretation conflicts with the overall structure of Chapter 13 and thus contravenes the holistic approach to statutory construction mandated by this Court in *Timbers*.

[18] Some courts permitting cram-down have provided debtor a third option, for which there is no basis under the Bankruptcy Code, of cramming down the claim to the value of the collateral and then curing the arrears and allowing the debtor to pay the crammed down value beyond the time limitation imposed by Section 1322(c). *See Sapos*, 967 F.2d at 928; *Bellamy*, 962 F.2d at 185. These courts have created this third option, notwithstanding the absence of any statutory authority for it, to avoid the effect of cram-down under the Bankruptcy Code of requiring debtor to pay the secured claim over the life of the Chapter 13 plan. The fact that courts allowing cram-down have recognized that it only benefits the debtor if further changes are made to the statutory scheme of Chapter 13 illustrates the fallacy of interpreting Section 1322(b)(2) to permit cram-down of residential mortgage claims.

V

CRAM-DOWN COULD HAVE A SEVERE NEGATIVE IMPACT ON CONGRESSIONAL POLICY FAVORING HOME OWNERSHIP

Consideration of Section 1322(b)(2) in light of the consistently expressed policy of Congress to encourage investment in home ownership also mandates the conclusion that cram-down of residential mortgage debt is impermissible under Chapter 13. A steady procession of Congressional enactments beginning in 1934 with the National Housing Act and continuing with the Department of Veterans Affairs Home Loan Guaranty Program, the Housing and Urban Development Act of 1968, the Emergency Home Finance Act of 1970, the Secondary Mortgage Market Enhancement Act of 1984 and the Tax Reform Act of 1986 evidence this clear Congressional policy favoring home ownership. To allow Chapter 13 debtors to cram-down their residential mortgage lenders will undermine this policy.[19]

Cram-down reduces the protection available to lenders through government home mortgage guaranty programs, for lenders who have been crammed down may look to the guarantor only for the reduced balance of the loan. Lenders will thus be required, in order to protect themselves, to seek larger down payments on home loans, especially in geographic areas of economic uncertainty, with the result that the policy of home mortgage guaranty programs — to make mortgages available even to those individuals who cannot afford a substantial down payment — will be frustrated.

Cram-down of residential mortgage debt will also have a negative impact on the secondary mortgage market, in which

[19] The suggestion by Amicus Curiae Harold J. Barkley, Jr. that cram-down only is an issue where junior liens exist on a property is belied by the very facts of this case and the countless other bankruptcy court, district court and circuit court cases in which no junior lien exists. The large number of such cases clearly illustrates that this issue is not limited to factual situations involving junior liens.

entities such as Freddie Mac purchase home mortgage loans and resell those mortgages to investors in the form of mortgage pass-through securities which represent interests in groups of mortgages. The secondary mortgage market has been an important means of increasing the supply, and reducing the costs, of home mortgage credit, and the smooth functioning of this market depends upon a predictable flow of principal and interest from home mortgages. If cram-down is permitted, and borrowers are allowed unilaterally to reduce the balance of their mortgage loans, this predictability will be undermined, and the ability of entities operating in the secondary mortgage market to continue to supply low-cost and plentiful credit to America's homeowners may be adversely affected.

In short, Congress has enacted pervasive and important legislative programs to foster home mortgages and home ownership in America. Congress recognized the potential harmful impact on these programs if cram-down of home loans was allowed, and it provided special protection for home mortgages in the Bankruptcy Code. The only interpretation of Section 1322(b)(2) consistent with this Congressional policy is that adopted by the Fifth Circuit – that a Chapter 13 debtor may not cram-down the claim of a residential mortgage lender.

CONCLUSION

For all the foregoing reasons, as well as those set forth in the Brief of Respondent, the decision of the United States Court of Appeals for the Fifth Circuit should be affirmed.

February 18, 1993

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In the Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,
Petitioners,

v.

AMERICAN SAVINGS BANK,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF FEDERAL NATIONAL MORTGAGE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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In the Supreme Court of the United States

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No. 92-641

LEONARD NOBELMAN AND HARRIET NOBELMAN,
Petitioners,

v.

AMERICAN SAVINGS BANK,
Respondent.

On Writ of Certiorari
to the United States Court of Appeals
For the Fifth Circuit

BRIEF OF
FEDERAL NATIONAL MORTGAGE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF AMICUS[1]

The Federal National Mortgage Association ("Fannie Mae") is a congressionally chartered, privately owned company created in 1938 to support housing finance by making a secondary market for residential mortgages. Fannie Mae fulfills its corporate mission by providing "ongoing assistance to the secondary market for home mortgages (including activities relating to mortgages on

[1] Pursuant to Supreme Court Rule 37.3, the Federal National Mortgage Association is filing its brief as amicus curiae with the consent of all the parties. The letters of consent are being filed with the Clerk simultaneously with the filing of this brief.

housing for low- and moderate-income families involving a reasonable economic return . . .)" and "by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing." 12 U.S.C. § 1716(3)-(4) (as amended by Pub. L. No. 102-550, § 1381, 106 Stat. 3672, 3994-95 (1992)).

Fannie Mae provides a secondary market for residential mortgage loans by purchasing such loans from a nationwide network of approximately 2,800 local mortgage lending institutions. Through its purchases, Fannie Mae replenishes lenders' supply of mortgage funds available for new loans. Fannie Mae has grown to be the nation's largest investor in home mortgages secured by properties for low-, moderate-, and middle-income families, and in the 1990s, expects to help well over 12 million American families buy homes. Fannie Mae purchases for its portfolio or holds in trust for investors one out of every four mortgages originated in the United States today.

Fannie Mae believes that the issue of Chapter 13 cramdowns is of great importance to the residential mortgage industry. Residential mortgages are more available and affordable than other types of consumer financing, in large part because residential property is inherently reliable collateral. If a mortgage loan may be bifurcated into secured and unsecured portions in the event that a borrower seeks relief under Chapter 13, lenders' confidence in this collateral will likely diminish.

Generally, the greatest obstacle to first-time home ownership is accumulating sufficient savings for a downpayment. Therefore, the key to home ownership for low- and

moderate-income borrowers, in particular, is the availability of low-downpayment mortgage financing. A lender will have less incentive to make high loan-to-value ratio loans if, in addition to foreclosure losses, the lender must anticipate a borrower's reducing home mortgage debt through a Chapter 13 bankruptcy filing whenever a temporary decline in housing values eliminates the borrower's equity. Thus, the potential of home mortgage cramdown in Chapter 13 could result in higher borrowing costs to prospective home owners overall, as well as tighter credit standards, making such financing more difficult to obtain, particularly for first-time and low-income buyers.

SUMMARY OF ARGUMENT

The plain language of section 1322(b)(2) mandates that a Chapter 13 plan may not alter the bargained-for rights of a home mortgage lender. By use of the word "claim" in the anti-modification clause of section 1322(b)(2), that section protects the home mortgage lender's full claim, as "claim" is defined in section 101(5)(A) of the Bankruptcy Code. The "rights" of the mortgage lender that are expressly exempt from modification under section 1322(b)(2) include not only the right of the lender to be paid what it is owed, but the right, in case of defaults, to foreclose on the property to recover as much as possible of the debt.

The legislative history of section 1322(b)(2) supports this reading of the plain language of the provision. Under the Bankruptcy Act, no claim secured by real estate of any type could be modified in a Chapter XIII wage-earner plan. While the 1977 House version of the proposed Bankruptcy Code proposed to eliminate this restriction, the 1978 Senate bill preserved it. Section 1322(b)(2), as enacted, represents

a compromise designed to afford special protection only to home mortgage lenders: claims secured by a security interest in a debtor's principal residence cannot be modified under a Chapter 13 plan.

Petitioners' contention that section 1322(b)(2) protects the lender's rights solely with respect to the secured portion of a claim bifurcated under section 506(a) is untenable. Applying section 506(a) to home mortgage debt would virtually nullify the protections of a lender's "rights" under section 1322(b)(2) since the lender would lose, among other things, the "right" to be paid what it is owed. The only sensible conclusion is that Congress included the anti-modification clause in section 1322(b) to prevent the application of section 506(a) to a home mortgagee's "claim." Thus, to the extent that the general provisions of section 506(a) conflict with the specific provision in section 1322(b)(2) prohibiting home mortgage cramdown, section 1322(b)(2) must govern.

If the language "a claim secured by" a security interest in section 1322(b)(2) is read to mean an "allowed secured claim," as that term is used in section 506(a), one must also read section 1322(b)(2) in light of section 506(d). As this Court stated in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992), section 506(d) does not allow voiding a lien where a claim that is secured has been allowed. When a home mortgagee's claim is secured and has been allowed, section 506(d) does not permit reducing the lien for the full outstanding amount of the loan to the value of the property.

Reading section 1322(b)(2) to allow cramdown of the home mortgage in a Chapter 13 bankruptcy is inconsistent with the purposes of that provision and of Chapter 13: the

home mortgage lender is significantly harmed without other creditors, or the debtor during the pendency of the plan, realizing any corresponding benefit. If the debtor's residence rises in value, solely the debtor will profit from this increase. As this Court stated in *Dewsnup*, there is no evidence that Congress intended mortgage lenders to receive such treatment.

Finally, mortgage cramdown in Chapter 13 would result in significantly worse treatment of a mortgage lender in Chapter 13 than in a Chapter 7 or 11 case. Under Petitioners' reading of section 1322(b)(2), only in a Chapter 13 case could a mortgage lender involuntarily lose the full lien for which it bargained. Congress could not have intended such harmful results to home mortgage lenders whose "rights" were to be protected.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 1322(b)(2) OF THE BANKRUPTCY CODE PROVIDES THAT THE RIGHTS OF A HOME MORTGAGE LENDER WITH REGARD TO ITS FULL "CLAIM" MAY NOT BE MODIFIED IN A CHAPTER 13 PLAN.

A. Use of the term "claim" in the anti-modification clause must be read in light of the definition of "claim" in section 101(5)(A) of the Bankruptcy Code.

"[S]tatutory interpretation begins with the language of the statute itself." *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990); *see also Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985). The plain language of section 1322(b)(2) states that the

"rights" of a home mortgage lender regarding its "claim" -- the full claim, not merely the portion of that claim that may be an "allowed secured claim" under a section 506(a) bifurcation -- may not be modified under a Chapter 13 plan.

Section 1322 reads in pertinent part:

> (b) Subject to subsections (a) and (c) of this section, the plan may --
>
> . . . .
>
> (2) modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . .

11 U.S.C. § 1322(b)(2) (1988) (emphasis added).

In setting out its one exception to modification, section 1322(b)(2) does not speak of a "secured claim," which is the term used in section 506(a) to refer to one of the products of claim bifurcation under that section. Instead, section 1322(b)(2) expresses its exception by reference to a "claim secured only" by a security interest in the Chapter 13 debtor's home. At least one bankruptcy court has recognized and well articulated the difference between these two terms:

> The restriction on modification [in section 1322(b)(2)] is not limited to so much of the claim as is secured, but extends to the entire claim, secured or unsecured, provided that the security consists only of a security interest in the debtor's principal residence.

> Those who would read the protection of Section 1322(b)(2) as limited to the secured portion of a home mortgage confuse the term "secured claim" with the phrase "claim secured only" by a home mortgage and disregard the difference in the function of the word "secured" in the two phrases. . . . Even if the mortgage exceeds the value of the residence so that the claim is not a secured claim, in the sense of wholly secured, it is still correctly described (if the creditor holds no other security) as "secured only by" a residential mortgage.[2]

The commas bracketing the anti-modification clause further indicate that the term "claim" in that clause should be read in light of the definition of "claim" set out in section 101(5)(A) of the Bankruptcy Code to include both secured and unsecured portions of a claim. The commas result in a syntax that "demonstrates an intent to maintain the independence of the anti-modification language from the 'secured claims' language preceding it. . . . This reinforces the conclusion that § 101(5)(A)'s definition of 'claim,' which is broad enough to include both secured and unsecured portions held by a single creditor, should be applied to § 1322(b)(2)." *In re Etchin*, 128 B.R. 662, 668 (Bankr. W.D. Wisc. 1991).

Section 506(a) itself (which, along with section 506(d), gave rise to the issue faced by this Court in the Chapter 7 context in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992)), differentiates between the terms "a secured claim" and a

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[2] *In re Strober*, 136 B.R. 614, 619-20 (Bankr. E.D.N.Y. 1992).

"claim secured by" a security interest and uses them in the manner explained above. Section 506(a) reads as follows:

> (a) An allowed *claim* of a creditor *secured by a lien on property* in which the estate has an interest . . . *is a secured claim* to the extent of the value of such creditor's interest in the estate's interest in such property . . . *and is an unsecured claim* to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

11 U.S.C. § 506(a) (1988) (emphasis added). As the language of section 506 itself indicates, a "claim" secured by a lien on property may be broader than a "secured claim" and thus, "an allowed claim . . . secured by a lien on property" may consist of both "a secured claim" and an "unsecured claim."

In sum, the restriction, or anti-modification clause, of section 1322(b)(2) speaks of a "claim." A reading of the plain language of the anti-modification clause requires no reference to section 506. It is section 101 of the Bankruptcy Code, not section 506, which defines a "claim."[3]

---

[3] Use of the word "claim" in the anti-modification clause of section 1322 is sufficient to indicate that the full claim is protected from modification, even absent a clause such as "notwithstanding section 506(a)" (as in section 1111(b)(2)). By way of example, section 363 provides that if property "subject to a lien that secures an allowed claim" is sold during a case or pursuant to a plan, the "holder of such claim" may bid and offset "such claim" against the bid. 11 U.S.C. § 363(k) (1988). There is no explicit clause in section 363(k) excepting the "allowed claim" from bifurcation under section 506(a) into secured and unsecured claims. Nonetheless, the legislative history indicates that the creditor may bid and offset its full claim. 124 Cong. Rec. H11093 (daily ed. September 28, 1978) (Rep. Edwards); 124 Cong. Rec. S17409 (daily ed. October 6, 1978) (Sen. DeConcini). *See, e.g.*, *Dewsnup*, 112 S. Ct. at 781, n.1 (Scalia, J., dissenting); *In re Realty Invs., Ltd.*, 72 B.R. 143, 146 (Bankr. C.D. Cal. 1987) (for bidding purposes, "allowed claim" is total claim without reference to value of property). Similarly, if "claim" in the anti-modification clause of section 1322(b)(2) is read in light of its definition in section 101, it is not necessary to add a phrase specifically excepting the operation of section 506(a). The phrase may be more necessary in section 1111(b)(2), where the provisions preceding that subsection discuss the conversion of a nonrecourse claim into a recourse claim.

B. The "rights" of a holder of a claim secured by the Chapter 13 debtor's home include the right to be paid in full, or in the alternative, the right to foreclose on the property to recover as much of the debt as possible.

Section 1322(b)(2) by its protection of the "rights of holders of" claims excepts from its reach modification of the rights of such holders, rather than merely modification of their claims. Therefore, as the Fifth Circuit stated, "even if the entirety of such a claim is not a secured claim (as per section 506(a)), the rights of a holder of such a claim may not be modified under section 1322(b)(2)." *In re Nobleman*, 968 F.2d 483, 488 (5th Cir. 1992). Transforming secured debt into unsecured debt and eliminating the lender's right to look to the property securing its loan for full repayment in the event that the borrower does not pay strikes at the heart of the secured transaction and alters the bargain of the lender and borrower *ex post facto*.

Petitioners read section 1322(b)(2) as obliging the Chapter 13 debtor to live up to the full bargain struck with the home mortgage lender -- except as to the most fundamental term of the transaction, the repayment of the amount due to the lender. As Section II. of this brief indicates, Congress intended to protect home mortgage lenders through the

anti-modification clause of section 1322(b)(2). To read the clause as protecting only that portion of a lender's claim that is an "allowed secured claim" pursuant to section 506(a) results in negligible protection for the secured lender compared to what is lost through claim bifurcation and lienstripping.

Petitioners and their amici point out that, under their interpretation of section 1322, the Chapter 13 debtor must continue to pay interest at the contractual rate and to make the full monthly payment required under the loan agreement, but only until the lender has received the value of the collateral, as fixed by the bankruptcy court, plus interest. They then contend that the lender loses the right to receive anything further and must release its lien on the property. Petitioners argue that this reading of section 1322(b)(2) recognizes and achieves the special protection that Congress intended to afford home mortgage lenders.[4]

Protection of the interest rate, amount of installment payments, and other loan requirements is virtually meaningless in comparison to the rights the secured home lender is obliged to forego.[5] As this Court has recognized, a

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[4] Under section 1325(a)(5), other secured creditors whose claims are modified by the debtor and paid out over time will receive interest at the prevailing market rate. 11 U.S.C. § 1325(a)(5) (1988). Under section 1322(b)(2), the home mortgagee will receive no more than the contractual rate. Thus, under Petitioners' interpretation of section 1322(b)(2), a home mortgage lender could find its secured claim reduced, its lien stripped down, and its interest fixed at less than market rate even though other secured creditors, not "protected" by section 1322(b)(2), are receiving a prevailing rate of interest on their claims.

[5] Petitioners note that one of the advantages to the debtor of mortgage cramdown and lienstripping is that refinancing becomes possible. *See* Petitioners' Brief at 8. Thus the protections that Petitioners assert for a lender's interest rate and amount of monthly payment are ephemeral and therefore a virtual nullity.

mortgage lender bargains for the right to look to the property in question for full payment if the borrower does not pay. "[T]he creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee." *Dewsnup*, 112 S. Ct. at 778. In taking a security interest in real property, the mortgagee runs the risk that the property may fluctuate in value. Petitioners would have this Court hold that, if the property declines in value, the debtor can reduce the mortgage debt to that level and deprive the mortgagee of any benefit of a later increase in value. This Court specifically rejected that argument in the Chapter 7 context in *Dewsnup*. "Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain." *Id.*[6]

This plain language reading of section 1322(b)(2) with regard to the rights of a home mortgage lender demonstrates that mortgage cramdown is impermissible because such cramdown alters fundamental rights of a home mortgage lender with respect to its claim that Congress stated were to be protected.

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[6] Furthermore, as Section IV. of this brief points out, the significant harm to the rights of the home lender is not balanced by a corresponding benefit to other creditors; *only* the Chapter 13 debtor will benefit from a later increase in the value of the home.

II. THE LEGISLATIVE HISTORY SUPPORTS THE PLAIN LANGUAGE READING OF SECTION 1322(b)(2).

A. The legislative history of section 1322(b)(2) shows that, with respect to home mortgage debt, Congress intended to continue the pre-Code practice that prohibited modification of a claim secured by real estate.

A reading of section 1322(b)(2) that recognizes the protection accorded to the rights of a home mortgage lender is confirmed by the legislative history.

Under Chapter XIII of the Bankruptcy Act, the predecessor of the current Chapter 13, a wage earner's plan of reorganization could not "deal with" any claim secured by real property.[7] A 1973 draft of the Bankruptcy Code proposed by the Commission on the Bankruptcy Laws of the United States recast the language on this point but continued the Chapter XIII practice.[8] The House version of the

[7] *See* The Bankruptcy Act of 1898, Pub. L. No. 61, 30 Stat. 544-66 (repealed 1978), § 606(1) (defining "claim" for purposes of a Chapter XIII plan to exclude claims secured by estates in real property or chattels real); § 606(4) (defining "debt" to include all claims); and § 646(2) (permitting a Chapter XIII plan to "include provisions dealing with secured debts, severally, upon any terms"). The interplay of these three sections of the Bankruptcy Act meant that a Chapter XIII plan could deal with all secured debts *except* debts secured by real estate.

[8] *See* Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973), Part II, Chapter VI: Plans for Debtors with Regular Income, Part 2, Proceedings Relating to Plan and Performance Thereunder, §§ 6-201(2) (allowing modification of debt secured by personal property and cure of defaults within a reasonable time) and (4) (permitting cure of defaults within a reasonable time of claims secured by a lien on the debtor's

Code, as advanced in H.R. 8200, 95th Cong., 1st Sess. (1977), allowed a Chapter 13 plan to modify the rights of holders of secured or unsecured claims without limitation.[9] The Senate bill, S. 2266, preserved the protections afforded all real property lenders under Chapter XIII of the Act. The language of the Senate bill provided that a Chapter 13 plan could:

> (2) modify the rights of holders of secured claims (other than claims wholly secured by mortgages on real property) or of holders of unsecured claims.

S. 2266, 95th Cong., 2d Sess. § 1322(b)(2) (1978).

Section 1322(b)(2) as it was enacted in 1978 was a compromise of both the Senate and House bills: the anti-modification clause was limited to mortgages on a debtor's principal residence (instead of all real property) and the word "wholly" was changed to "only". This compromise position came about in response to "perceptions, or to suggestions advanced in the legislative hearings, . . . that,

residence) and notes thereto.

From 1973 through 1975, both houses of Congress introduced bills to revise the bankruptcy laws. The language of these bills (none of which was passed) more or less tracked the language of section 6-201. The bills introduced in 1977 and 1978 that were enacted in amended form as the Bankruptcy Code, H.R. 8200 (and its predecessors in 1977) and S. 2266, no longer tracked the language of section 6-201. *See* text *infra*.

[9] H.R. 8200, 95th Cong., 1st Sess. § 1322(b)(2) (1977) read as follows:

> Subject to subsections (a) and (c) of this section, the plan may--
>
> . . . .
>
> (2) modify the rights of holders of secured claims or of holders of unsecured claims; . . .

home-mortgagor [sic] lenders, performing a valuable social service through their loans, needed special protection against modification thereof (*i.e.*, reducing installment payments, secured valuations, etc.)." *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 246 (5th Cir. 1984) (en banc).[10] The compromise language of the present section 1322(b)(2) was thus adopted to preserve the protection that home mortgage lenders had under Chapter XIII and under the Senate bill but to limit that protection only to holders of claims secured by *home* mortgages.[11]

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[10] At Senate hearings held in 1977, representatives of mortgage lenders had expressed concern over the language of the House bill that allowed broad modification of the rights of home mortgage lenders. Edward J. Kulik, Senior Vice President, Real Estate Division, Massachusetts Mutual Life Insurance Co., testified that modifying a mortgagee's secured claim would have a significant negative impact on the home mortgage industry:

> The proposed chapter 13 in both bills, providing for the adjustment of debts of an individual with regular income, includes [a] fairly significant change[], compared to existing law, that may have the unintended effect of restricting the flow of home mortgage money.
>
> . . . .
>
> Serious consideration should be given to modifying [the House bill] so that, at the least . . . a mortgage on real property other than investment property may not be modified . . . .

Bankruptcy Reform Act of 1978: Hearings on S. 2266 and H.R. 8200 before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, 95th Cong., 1st Sess. 714 (1977).

[11] *See* 124 Cong. Rec. H11047 (daily ed. September 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S17424 (daily ed. October 6, 1978) (statement of Sen. DeConcini) ("Section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate amendment.")

The legislative history of section 1322(b)(2) supports the reading of the plain language of the statute: through the anti-modification clause, Congress intended to prohibit lienstripping with respect to home mortgage debt.

B. The legislative history of Chapter 12 and section 1222(b)(2), modelled on section 1322(b)(2), shows that Congress understood section 1322(b)(2) to prohibit a stripdown of the home mortgage.

In 1986, Congress enacted the "Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986."[12] Among other things, this law added to the Bankruptcy Code a new chapter -- Chapter 12 -- that was intended to accommodate the financial problems of family farmers better than either Chapter 11 or Chapter 13.[13] Section 1322(b)(2) served as a model for section 1222(b)(2) with one important variation: section 1222(b)(2) lacks the anti-modification clause.[14]

Testimony by a leading academic, who was the executive director of the commission that proposed the Bankrupt-

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[12] Pub. L. No. 99-554, 100 Stat. 3088 (1986) (codified as amended in scattered sections of Titles 11 and 28 of the United States Code).

[13] *See* H. Rep. No. 958, 99th Cong., 2d Sess. 48 (1986).

[14] Section 1222(b)(2) reads as follows:

> (b) Subject to subsections (a) and (c) of this section, the plan may--
>
> . . . .
>
> (2) modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . .

11 U.S.C. § 1222(b)(2) (1988).

cy Code, and comments by a sponsor of the Chapter 12 legislation, suggest that the anti-modification clause of section 1322(b)(2) was understood to forbid "cramdown" or "lienstripping". Because Congress did intend to allow family farmers the right to strip down their debts secured by real estate that had declined in value, Congress did not include the anti-modification clause in section 1222(b)(2).

In the hearings on the bankruptcy provisions concerning the family farmer,[15] Prof. Frank R. Kennedy, who testified on behalf of the National Bankruptcy Conference, responded to a specific question regarding section 1322(b)(2) and its scope. Prof. Kennedy had served as executive director of the Commission on Bankruptcy Laws of the United States at the time of the passage of the Bankruptcy Code.[16] Responding to a letter from Rep. Rodino asking him to elaborate on the desirability of allowing a family

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[15] *Farm Bankruptcy Amendments: Hearing on H.R. 1397 and H.R. 1399 before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 99th Cong, 1st Sess. (1985) [hereinafter the "Farm Bankruptcy Amendments Hearing"].

[16] While, under the general principles of statutory interpretation, little, if any weight, is to be accorded the testimony of witnesses in legislative hearings, *Kelly v. Robinson*, 479 U.S. 36, 51 n.13 (1986), the testimony and statements of Prof. Kennedy merit more than usual consideration. Prof. Kennedy is a recognized expert in the bankruptcy area, had an academic career that spanned four decades, and played a leading role in bankruptcy reform. *See, e.g.*, 124 Cong. Rec. S17404 (daily ed. October 6, 1978) (remarks of Sen. DeConcini thanking Prof. Kennedy for his work on the bankruptcy legislation); Vern Countryman, "Frank R. Kennedy," 82 Mich. L. Rev. 195, 195 (1983) ("No one knows more about the law of debtor and creditor than Frank Kennedy.").

farmer to modify the secured debt on his residence, Prof. Kennedy wrote:

> Section 1322(b)(2) now precludes any modification of a claim secured only by real property that embraces the family farmer's home. *Thus, the debtor's plan of adjustment cannot reduce the amount of the principal or of any installment payable on such secured indebtedness and cannot extend the maturity date of the obligation or postpone the payment of any installment of the principal or interest.*[17]

It was against this background that Congress enacted section 1222(b)(2) to allow the family farmer to stripdown all secured debt. During Congressional debates on the proposed Senate bill, Sen. Grassley, a sponsor of the legislation, introduced into the Congressional Record the section-by-section analysis of the bill, which included the following regarding section 1222(b)(2):

> What must be in the plan comes primarily from chapter 11. What may be in the plan comes from both chapter 13 and chapter 11. In chapter 13 a debtor may not modify the mortgage on his residence (§ 1322(b)(2))--that provision was omitted and the debtor would be able to rearrange his home mortgage in chapter 12, just as he can in chapter 11.[18]

In passing Chapter 12, Congress recognized that it was affording broader relief to the family farmer than was ac-

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[17] Farm Bankruptcy Amendments Hearing at 130 (emphasis added).

[18] 132 Cong. Rec. S5557 (daily ed. May 7, 1986) (section-by-section analysis introduced into record by Sen. Grassley).

corded to other debtors under other chapters of the Bankruptcy Code. This broader relief included the right to strip down home mortgage liens, which Congress understood was unavailable in Chapter 13.[19]

[19] An amicus brief filed in support of Petitioners' position argues that bills introduced in 1992 in both houses of Congress indicate that Congress was aware that section 1322(b)(2), as written, does not prevent the stripdown of residential mortgages. Brief of Consumer Education and Protective Association, et al. as Amici Curiae in Support of Petitioners, pp. 42-45. This contention is not supported by the legislative history. The amendments to section 1322(b)(2) considered by Congress in 1992 simply recognized the split of the courts on the permissibility of cramdown and, if they indicate anything, it is that Congress intended to *clarify*, not change, the meaning of the section 1322(b)(2) anti-modification clause. *See* S. 1985, 102d Cong., 2d Sess. § 310 (1992); S. Rep. No. 279, 102d Cong., 2d Sess. 40-41 (1992) (indicating that the revision was "designed to *clarify* the Bankruptcy Code and congressional intent on the problem which is often referred to as "cramdowns" or "lien stripping". Currently caselaw is unsettled regarding the ability of the bankruptcy court to make a cramdown. . . . This section is designed to protect the entire claim in the case of first mortgages, not only that portion of the claim which would be secured pursuant to the status provided by section 506 of the code.") (emphasis added); *see also* H.R. 6020, 102d Cong., 2d Sess. § 202 (1992); H. Rep. No. 996, 102d Cong., 2d Sess. 21-22 (1992) (section-by-section analysis); *Consumer Issues in Bankruptcy: Hearing before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, 102d Cong., 2d Sess. 3 (1992) (Rep. Hamilton Fish, Jr. stating, "[W]e need to make it clear, consistent with the recent Supreme Court decision regarding chapter 7, that a chapter 13 debtor can't 'cram down' or 'strip down' the value of his/her primary mortgage obligation.").

III. TO THE EXTENT THE LANGUAGE OF SECTION 1322'S ANTI-MODIFICATION CLAUSE MUST BE READ IN CONJUNCTION WITH SECTION 506, APPLICABLE LAW AND PRINCIPLES OF STATUTORY CONSTRUCTION CONFIRM THAT LIENSTRIPPING IS PROHIBITED.

A. Under the principle that specific statutory language governs over general language, the language of section 1322 supersedes section 506(a).

Section I.B. of this brief discussed the significant and adverse change to the rights of a home mortgage lender that results from mortgage cramdown. To the extent that the section 1322(b)(2) prohibition on mortgage cramdown conflicts with claim bifurcation under section 506(a), section 1322 must govern in a Chapter 13 case.

It is a basic principle of statutory construction that a specific statute controls over a more general statute.[20] Section 506 is a provision of general applicability in cases under Chapters 7, 11, 12, and 13 of the Bankruptcy Code. 11 U.S.C. § 103(a) (1988). Section 1322, however, applies only in Chapter 13 cases. 11 U.S.C. § 103(h)(1988). To the extent that section 1322(b)(2) is deemed to be inconsistent or contradictory with section 506(a), section

[20] *See Maiatico v. United States*, 302 F.2d 880, 886 (D.C. Cir. 1962); *In re Schum*, 112 B.R. 159, 160-61 (Bankr. N.D. Tex. 1990); *In re Sauber*, 115 B.R. 197, 199 (Bankr. D. Minn. 1990); *In re Lee*, 35 B.R. 452, 456 (Bankr. N.D. Ga. 1983) (all provisions of Chapter 1, 2, and 5 cannot be applied with identical force to each of Chapter 7, 11, and 13).

1322(b)(2) must be read to supersede section 506(a).[21] Thus, should the Court decide that stripdown of a home mortgage lien is prohibited under section 1322(b)(2) but that section 506(a) does apply to bifurcate a lender's claim, the specific prohibition of section 1322(b)(2) must take precedence over the general application of section 506.

B. If the language of section 1322's anti-modification clause is to be read in light of section 506, the reading must include section 506(d), which *Dewsnup* held prohibits lienstripping.

If the Court accepts the argument that sections 506(a) and 1322(b)(2) can be read together without conflict, such that a "claim secured by" a security interest in the anti-modification clause of section 1322(b)(2) equates to an "allowed secured claim" (one of the products of bifurcation under section 506(a)), this reading does not result in the conclusion that the Chapter 13 debtor's home mortgage lien may be stripped down. If section 1322(b)(2) and section 506(a) indeed mean that only a secured lender's "allowed secured claim" is protected from modification, the mortgagee's lien will be voided to the extent that it exceeds the value of the collateral only if section 506(d) applies to that lien. This Court did state in *Dewsnup*, however, that when "the claim . . . has been 'allowed' pursuant to § 502 of the Code and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of § 506

[21] *See In re Russell*, 93 B.R. 703, 705 (D.N.D. 1988); *In re Hynson*, 66 B.R. 246, 249-50 (Bankr. D.N.J. 1986); *In re Hemsing*, 75 B.R. 689 (Bankr. D. Mont. 1987).

(d), which voids only liens corresponding to claims that have *not* been allowed and secured." 112 S. Ct. at 777 (emphasis in original). Thus, under section 506(d), if a home mortgage lender's claim has been allowed and is secured, the lender's lien cannot be stripped down.

The Court in *Dewsnup* recognized that, "[u]nder the Bankruptcy Act of 1898, a lien on real property passed through bankruptcy unaffected." *Id.* at 778-79. Because Congress enacted the Code "with a full understanding of th[e] practice" that accorded respect to a secured lender's lien, this principle continues to be valid under the Code. *Id.* at 779. "Ordinarily, liens and other secured interests survive bankruptcy." *Farrey v. Sanderfoot*, 111 S. Ct. 1825, 1829 (1991). "[A] bankruptcy discharge extinguishes only one mode of enforcing a claim -- namely, an action against the debtor *in personam* -- while leaving intact another -- namely an action against the debtor *in rem*." *Johnson v. Home State Bank*, 111 S. Ct. 2150, 2154 (1991).

The same policies that prohibit cramdown in a Chapter 7 are applicable to a Chapter 13 bankruptcy. Section 506(d) does not allow cramdown of a claim that has been allowed and is secured in a Chapter 7 case and likewise does not allow cramdown of such a claim in a Chapter 13 case.

IV. READING SECTION 1322(b)(2) TO PROHIBIT CRAMDOWN OF RESIDENTIAL MORTGAGES IS CONSISTENT WITH THE PURPOSES OF CHAPTER 13 AS A WHOLE.

Only the debtor may propose a plan under Chapter 13.[22] Thus, any limitations on provisions of a plan must be for the benefit of creditors rather than for the benefit of the debtor. *In re Hall*, 117 B.R. 425, 428 (Bankr. S.D. Ind. 1990). Yet the reading that Petitioners and amici give to section 1322(b)(2) does not further the purposes of section 1322(b)(2) or of Chapter 13: it results in no immediate benefit to the Chapter 13 debtor, does not increase the return to other creditors, and at the same time affords virtually no protection to the home mortgage lender.

Chapter 13 is designed to reduce an individual debtor's debt burden to an amount that he can pay out of his future income, while allowing him to keep assets beyond the exemptions allowed in a Chapter 7 liquidation. The Chapter 13 debtor proposes a plan under which all of his disposable income for a period of 36 to 60 months is devoted to paying past debt.[23] Upon completion of payments under the plan, the debtor is discharged of the debts that are treated under the plan.

As shown in Section I.B. of this brief, Petitioners' interpretation of section 1322(b)(2) preserves few of the rights of the home mortgagee. At the same time, their reading results in no immediate benefit to the debtor, since they agree that installment payments must continue at the

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[22] "The debtor shall file a plan." 11 U.S.C. § 1321 (1988).

[23] *See* 11 U.S.C. §§ 1322(a)(1) and (c) (1988).

full amount set forth in the loan agreement. Furthermore, other creditors are harmed as a result of bifurcation of the mortgagee's claim: the mortgagee now has an unsecured deficiency claim and any distribution on the mortgagee's unsecured claim reduces the amount paid to other unsecured creditors. The benefit that Petitioners and amici see from cramdown of a mortgage claim -- the "light at the end of the tunnel" that results from an earlier retirement of the mortgage debt[24] -- is (in most instances) a benefit that accrues *solely* to the debtor. As this Court stated in *Dewsnup*, there is no evidence that Congress intended such a result. 112 S. Ct. at 778.[25]

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[24] Petitioners' Brief at 7.

[25] Amici who have filed briefs in support of Petitioners' position emphasize the situation of debtors who have senior and junior mortgages on their homes. The case before this Court, however, involves cramdown of a primary, purchase-money home mortgage, and the issue presented is the extent of protection granted by the anti-modification clause to claims falling within its scope -- that is, the permissibility of claim bifurcation and lienstripping with regard to home mortgage debt. The scope of the anti-modification clause -- whether or not section 1322(b)(2) protects primary and junior (purchase- and non-purchase money) mortgage loans or only primary mortgage loans -- is a question distinct from the question before the Court in this case. *See, e.g., In re Diquinzio*, 110 B.R. 628 (Bankr. D.R.I. 1990); *In re Shaffer*, 84 B.R. 63, 66 (Bankr. W.D. Va.), *aff'd and remanded on other grounds*, 116 B.R. 60 (W.D. Va. 1988).

Congress encouraged home equity loans as a result of the Tax Reform Act of 1986, Pub. L. No. 99-524, § 1231(e)(1), 100 Stat. 2085 (1986), which phased out the deduction for interest paid on consumer debt but allows a deduction for interest paid on home mortgage debt. If it determines to limit the protection of section 1322 as to junior and nonpurchase-money mortgagees, Congress can do so. But purchase-money home mortgagees should not be deprived of that protection simply because of the recent growth of home equity loans.

V. READING SECTION 1322(b)(2) TO PROHIBIT CRAMDOWN OF RESIDENTIAL MORTGAGES IS CONSISTENT WITH THE TREATMENT SUCH MORTGAGES WOULD RECEIVE UNDER CHAPTERS 7 AND 11 OF THE BANKRUPTCY CODE.

"A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme. . . because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Savings Association v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371 (1988). A comparison of the treatment of an undersecured home mortgage lender's claim in Chapters 7, 11 and 13 indicates that home mortgage stripdown in Chapter 13 would be contrary to, and incompatible with, the result in Chapters 7 and 11.

Chapter 7. Under *Dewsnup*, a Chapter 7 debtor may not use sections 506(a) and (d) to avoid the portion of a mortgage lien that exceeds the value of the property. As a result, the Chapter 7 undersecured mortgage creditor is allowed to realize the full value received upon sale of the property up to the amount of its lien.

Chapter 11. In Chapter 11, now open even to individuals not actively engaged in business, *Toibb v. Radloff*, 111 S. Ct. 2197 (1991), the undersecured mortgage creditor has a choice if the debtor decides to retain the property securing the creditor. Under the first option, pursuant to section 1111(b)(1)(A), the undersecured creditor's claim, whether a recourse or nonrecourse obligation, will be treated as a secured claim to the extent of the value of the collateral and as an unsecured claim to the extent that the claim

exceeds the value of the collateral. As to its secured claim, under section 1129(b)(2)(A) the creditor must receive a stream of payments having a present value equal to the value of the collateral. The creditor's unsecured claim will receive the same distribution as other unsecured claims under the Chapter 11 plan.

There is, however, a second option open to the undersecured creditor. Under section 1111(b)(2), the undersecured creditor may elect to forego its unsecured claim (and a distribution on that claim) and "notwithstanding section 506(a) of this title, such claim [of the creditor] is a secured claim to the extent that such claim is allowed." 11 U.S.C. § 1111(b)(2) (1988). Thus, under section 1111(b)(2) the undersecured creditor may decide to retain its lien for the full amount of its claim, in which event it will receive payments equal to the full value of its claim with a present value equal to the amount of its interest in the estate's interest in the collateral. 11 U.S.C. § 1129(a)(7)(B) (1988).

The undersecured creditor may decide to make the section 1111(b)(2) election in a number of circumstances. It may believe that the bankruptcy court's valuation of the property in question, for purposes of determining the secured and unsecured portions of its claim under section 506(a), was too low. Too low a valuation (resulting in too small a secured claim) in combination with a small (or no) distribution to unsecured creditors may make it more profitable for a creditor to forego its unsecured claim in order to retain a lien for the full amount of its claim. Undersecured creditors will elect the section 1111(b)(2) option if they believe that the property was undervalued or valued in a declining market and is likely to appreciate in value and

if they further believe that the debtor will sell the property or will default on its obligations once out of bankruptcy.[26]

Thus, in Chapter 11, an undersecured lender will not see its secured interest, or lien, reduced involuntarily. Section 1111(b)(2) allows the undersecured creditor in Chapter 11 the option of retaining its lien for the full amount of its claim if the creditor believes that it will be to its benefit to do so.[27]

Chapter 13. Under the position advanced by Petitioners, a Chapter 13 debtor would be able to pay only a portion of what is due to the undersecured home mortgage lender, as fixed in a valuation hearing before plan confirmation, and retain for himself all the benefits of a subsequent increase in value of the residential property. Under the position advocated by Respondent and amicus Fannie

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[26] Most home mortgages, for example, contain a due-on-sale clause, because mortgage purchasers in the secondary market, like Fannie Mae and the Federal Home Loan Mortgage Corporation, require such a provision if the mortgage is to be eligible for purchase. Thus, if the property is sold after the bankruptcy case, the mortgagee will have the right to be paid, upon such sale, to the full extent of its lien.

[27] Section 1111 was enacted in reaction to pre-Code decisions in *In re Pine Gate Assocs., Ltd.*, No. B75-4345A (N.D. Ga.), dating from the mid-1970s. *See* 5 *Collier on Bankruptcy* ¶ 1111.02 at 1111-21 (15th ed. 1988). In that case, under Chapter XII of the Bankruptcy Act, a real estate lender held a nonrecourse note secured by an apartment complex worth less than the amount of the debt. Debtor proposed to satisfy the lender's claim by paying to the lender an amount equal to the current value of the property, but paying nothing on any deficiency claim. Debtor was thus able to eliminate the lender in a slumping real estate market and be the sole beneficiary in a rising market. Section 1111(b) obviates the evils of the *Pine Gate* scenario by giving the undersecured creditor a choice.

Mae, a home mortgagee would retain the same rights in Chapter 13 that it has outside of bankruptcy: the mortgagee would be paid under the terms of its mortgage loan by the Chapter 13 debtor or would have the right to foreclose on the property. The retention of the full mortgage lien is consistent with the rights of secured lenders in Chapters 7 and 11. There is no indication that Congress enacted section 1322(b)(2) to provide a windfall to the Chapter 13 debtor, at the expense of the secured lender and possibly other unsecured creditors, which is the outcome under Petitioners' reading of that provision.

Chapter 20. An individual who filed a Chapter 7 bankruptcy petition may subsequently file a Chapter 13 petition.[28] Under Petitioners' reading of section 1322(b)(2), Chapter 13 may become a haven for those individuals seeking to strip down their home mortgages -- whether or not such individuals are initially eligible for Chapter 13.

An individual who might not initially be eligible for Chapter 13 may decide to file serial petitions in Chapter 7 and then in Chapter 13, a Chapter "20", in order to take advantage of the stripdown afforded by Chapter 13 under Petitioners' reading of that section. First, the debtor would file a Chapter 7 petition to obtain a discharge of unsecured debts that make the debtor ineligible for Chapter 13 or, as in *Johnson*, to eliminate the debtor's recourse liability on a mortgage. Although under *Dewsnup* the debtor will not be able to strip down his home mortgage lien in the Chapter 7

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[28] *Johnson v. Home State Bank*, 111 S. Ct. 2150, 2156 (1991) ("Congress did not intend categorically to foreclose the benefit of Chapter 13 reorganization to a debtor who previously has filed for Chapter 7 relief.").

proceeding, immediately after obtaining a discharge in Chapter 7 (before the secured mortgage lender can exercise its rights of foreclosure), the debtor can then file a Chapter 13 petition in order to keep his home -- and stripdown the mortgagee's lien.

In sum, lienstripping in Chapter 13 would result in less protection to the home mortgage lender in a Chapter 13 case, where Congress intended to protect home mortgage lenders, than in a Chapter 7 or 11 case. There is no indication that Congress intended that a debtor's choice of bankruptcy proceeding should result in such disparate treatment of a home mortgage lender.

CONCLUSION

The anti-modification clause of section 1322(b)(2) of the Bankruptcy Code protects the rights of the holder of a home mortgage claim to the full extent of the claim. The lower courts and the Fifth Circuit in this case have correctly interpreted the provision to prohibit cramdown of a home mortgage claim and lienstripping. This reading of the statute is consistent with the legislative history and with the purpose of Chapter 13 and of the Bankruptcy Code as a whole. The judgment of the Fifth Circuit should be affirmed.

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

v.

AMERICAN SAVINGS BANK,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF MORTGAGE BANKERS ASSOCIATION OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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BRIEF OF MORTGAGE BANKERS ASSOCIATION OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

STATEMENT OF INTEREST

Mortgage Bankers Association of America ("MBAA") files this brief *amicus curiae* in support of respondent American Savings Bank with the consent of the parties. Copies of the letters of the parties indicating consent to the filing of this brief are being filed with this brief.

MBAA is a national trade association representing mortgage banking companies, financial institutions, and other entities participating in the home mortgage market. MBAA represents the interests of its 2400 participating

members through its research functions and through involvement in legislative and judicial proceedings. MBAA filed a brief *amicus curiae* in support of respondent with the United States Court of Appeals for the Fifth Circuit.

The matter at issue in the case at bar will have a significant impact upon MBAA because the modification of home mortgages as advanced by petitioners would have serious adverse effects on the home mortgages, mortgage markets, and mortgage credit markets in which *amicus'* member institutions are involved. Under petitioners' interpretation of Bankruptcy Code section 1322(b)(2), *amicus'* member institutions will be unable to realize the full value of their loans, and may be compelled to curtail investing in home mortgages or mortgage-backed securities because of anticipated losses.

STATEMENT OF ISSUES ADDRESSED BY *AMICUS CURIAE*

Does Bankruptcy Code section 1322(b)(2), 11 U.S.C. § 1322(b)(2) (1988), prohibit a Chapter 13 debtor from modifying the rights of a creditor holding a claim secured only by a mortgage on the debtor's principal residence?

STATEMENT OF THE CASE

Amicus adopts respondent's Statement of the Case. Petitioners are Chapter 13 debtors in this bankruptcy case. Respondent holds the mortgage secured by petitioners' primary residence. Because the value of the residence has decreased, petitioners have attempted to modify respondent's rights by bifurcating the amount owing on their home mortgage into secured and unsecured portions, so as to repay the secured portion outside of the proposed plan, and to discharge the balance with unsecured debts under the proposed plan. The Court of Appeals for the Fifth Circuit affirmed the denial of petitioners' proposed reorganization plan.

SUMMARY OF ARGUMENT

Amicus will not repeat the detailed discussion of the language, structure, and history underlying Bankruptcy Code section 1322(b)(2) so ably set forth in Respondent's Brief and the Brief for *Amici Curiae* Federal Home Loan Mortgage Corporation and Residential Funding Corporation ("FHLMC Brief"). As demonstrated in those briefs, Bankruptcy Code section 1322(b)(2) expressly prohibits a Chapter 13 debtor from modifying the rights of a creditor holding a claim secured only by a mortgage on the debtor's principal residence. Furthermore, as the court below properly decided, section 506(a) of the Code does not alter the operation of section 1322(b)(2) to permit a Chapter 13 debtor to "cram down" a residential mortgage creditor's secured claim to the value of the property,

since such a cram down would allow the debtor to modify the creditor's rights, the very result forbidden by section 1322(b)(2). Allowing bifurcation and cram down would quite simply, as recognized by the court below, "vitiate the protection of section 1322(b)(2)." *In re Nobelman*, 968 F.2d 483, 489 (5th Cir. 1992). Moreover, if there is any doubt about the plain meaning of section 1322(b)(2), the Court should interpret the provision to recognize the congressional purpose of fostering affordable home financing and insulating home mortgages from Chapter 13 modification. To permit Chapter 13 modification of claims secured by home mortgages would be contrary to the congressionally-fostered system for providing secure, affordable, and easily attainable home loans for Americans.

ARGUMENT

I. IN CONSTRUING BANKRUPTCY CODE SECTION 1322(b)(2), THIS COURT SHOULD CONSIDER THE MEANING AND INTENT OF CONGRESSIONAL POLICY.

For all the reasons stated in Respondent's Brief and the FHLMC Brief, *amicus* believes that the plain meaning of Bankruptcy Code section 1322(b)(2) forbids Chapter 13 debtors from modifying the rights of creditors secured by a mortgage on the debtor's principal residence. Moreover, even assuming the statute's plain language did not definitely resolve the issue, the decision of the court below is the only result that can be squared with the intent and policy of Congress. It is well settled that the

Court may and should take account of Congress' purposes and interest when interpreting ambiguous statutes. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975) (when contours of statute may not be divined from statute's text, it is proper to consider legislative policy considerations); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S. Ct. 1026, 1031 (1989) (permissible to consider drafter's intentions and "important state and federal interest[s]" when meaning is inconclusive).

In Bankruptcy Code section 1322(b)(2), Congress obviously meant to offer home mortgage lenders protection from Chapter 13 debtors' modification of home mortgages. Congress' overwhelming policy to foster affordable and easily available home mortgages compels the interpretation of section 1322(b)(2) that protects the entire amount of home mortgage loans.

That section 1322(b)(2) does not permit cram downs is apparent not only from its text, but also from its legislative history. As discussed in more detail in Respondent's Brief and the FHLMC Brief, under pre-Bankruptcy Code practice, and specifically under Chapter XIII of the Bankruptcy Act of 1898, an individual's plan could not modify the rights of any creditor holding a claim secured by real property. Section 1322(b)(2) represents a compromise between the House of Representatives, which originally proposed to allow the modification of any secured claims, H.R. 8200, 95th Cong., 1st Sess. § 1322(b)(2) (1977), and the Senate, which proposed to preserve the Chapter XIII protection to all creditors holding claims secured by real property. S. 2266, 95th Cong., 1st Sess. § 1322(b)(2) (1977). *See In re Nobleman*, 968 F.2d at 488-89;

Grubbs v. Houston First American Sav. Ass'n, 730 F.2d 236, 246 (5th Cir. 1984) (*en banc*). In striking this compromise, Congress was motivated by its desire to preserve the availability of residential mortgage lending for individuals who could not otherwise afford to buy a home,[1] and by its concern, as expressed by witnesses during legislative hearings, that allowing modification of the rights of residential mortgage lenders could dry up the residential mortgage market. *Id.* Cram downs are precisely the kind of modifications that would have such an adverse effect, and they are thus precisely the kind of modifications that section 1322(b)(2) was designed to prevent.

This analysis tracks that of the Court's decision last Term in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992). In deciding that a debtor could not use section 506(d) of the Bankruptcy Code, in conjunction with section 506(a), to "strip down" a creditor's lien on real property to the value of the collateral,[2] the Court relied in large part on

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[1] Even those courts that have allowed cram downs have acknowledged the congressional purpose of protecting residential real estate lenders. *See, e.g., In re Bellamy*, 962 F.2d 176, 181-82 (2d Cir. 1992); *In re Hougland*, 886 F.2d 1182, 1185 (9th Cir. 1989).

[2] In *Dewsnup*, the Court rejected a debtor's argument that section 506(d) of the Code allows the debtor to void any lien to the extent it exceeds the value of the property securing the debt. The Court refused to resolve the ambiguous text of section 506(d) by giving the words "allowed secured claim" in that section the same meaning those words have in section 506(a), in part because such a construction would depart from pre-Code law and in part because such a construction would give the debtor an unbargained-for windfall in the event that the property subsequently appreciated in value. *Id.* at 778. The same

the fact that pre-Code bankruptcy law did not allow such a practice and there was "nothing in the Code's legislative history that reflects any intent to alter that law." *Id.* at 777. As the Court put it,

> [T]o attribute to Congress the intention to grant a debtor the broad new remedy against the allowed claims to the extent that they become "unsecured" for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles.

Id. at 779.

The Court's reasoning in *Dewsnup* is fully applicable here. As discussed, it is undisputed that under pre-Code bankruptcy law, a Chapter XIII debtor could not alter or in any way (including through a cram down) modify a claim that was secured by the debtor's real property. Although in enacting the Code Congress allowed modification in situations other than claims secured by the debtor's principal residence, there is no indication in the Code's legislative history that, with respect to claims secured by the debtor's principal residence, Congress intended to do anything other than to preserve the pre-Code protection against modification in all of its forms.

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analysis applies fully here, as the cram down relief sought by petitioners clearly departs from pre-Code law and would give petitioners the same windfall discussed in *Dewsnup*. Furthermore, respondent's case is even stronger here than was the creditor's in *Dewsnup* because section 1322(b)(2) contains an *explicit* prohibition against modification.

Indeed, the legislative history demonstrates that Congress specifically intended to protect the rights of residential mortgage lenders. Thus, when "Congress amends the bankruptcy laws, it does not write 'on a clean slate,' " *Dewsnup*, 112 S. Ct. at 779 (citation omitted), and because there is no indication in the Code's legislative history that Congress intended to permit cram downs, this Court should not attribute to Congress the intent to grant petitioners the "broad new remedy" they assert. *Id.*

Finally, if the Court focuses, as it must, on the structure of section 1322 as a whole, it should conclude that the Fifth Circuit's decision was correct. The interrelationship among section 1322(b)'s provisions, and particularly, the interrelationship between sections 1322(b)(2) and 1322(b)(5), demonstrate an inherent weakness in petitioners' proffered construction. Section 1322(b)(5) allows the debtor, when the repayment period under the original lender-borrower agreement is longer than the three to five year term of the debtor's plan, to cure any prior default and pay arrearages on any secured or unsecured claim over a reasonable time.[3] By far the most common type of individual debt which has a term longer than

[3] Section 1322(b)(5) provides that a plan may

> notwithstanding paragraph (2) of this subsection [section 1322(b)(2)], provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.

three to five years is the home mortgage.[4] Thus, section 1322(b)(5) provides a significant remedy to debtors that is not limited by section 1322(b)(2)'s prohibition on modification. However, the relief provided by section 1322(b)(5) – the ability to pay arrearages over time – does not extend to allow the debtor to miss or restructure current or future payments under the original loan agreement.[5] By granting this limited relief to debtors, Congress sought to protect debtors against the loss of their homes because of non-payment of arrearages while at the same time protecting the residential mortgage industry (with the ultimate goal of facilitating home ownership) by protecting against any further modification of the creditor's rights. To allow cram downs upsets this delicate but limited remedy specifically enacted by Congress and tramples on congressional intent.

[4] *See* 5 Lawrence P. King, *Collier on Bankruptcy* ¶ 1322.09[1] (15th ed. 1992) ("Although section 1322(b)(5) is not limited to secured or residential loans, its most common use by far is to cure defaults on residential mortgages.").

[5] Moreover, the ability of the debtor to cure a default and pay arrearages over a reasonable period of time under section 1322(b)(5) is not, in any way, deemed a modification of the secured claim within the meaning of section 1322(b)(2). *See, e.g., In re Taddeo*, 685 F.2d 24 (2d Cir. 1982); *Landmark Fin. Serv. v. Hall*, 918 F.2d 1150 (4th Cir. 1990).

II. THE SECTION 1322(b)(2) PROHIBITION AGAINST THE MODIFICATION OF THE RIGHTS OF A CREDITOR HOLDING A CLAIM SECURED ONLY BY A MORTGAGE ON THE CHAPTER 13 DEBTOR'S PRINCIPAL RESIDENCE PROMOTES CONGRESS' POLICY OF FOSTERING AFFORDABLE HOME FINANCING.

A steady procession of congressional enactments demonstrates Congress' policy to encourage capital investment in home ownership in order to provide affordable home financing for Americans. Congress has sought to implement this goal in two main ways: (1) by providing for mortgages guaranteed by the government, and (2) by fostering a vital, effective, and secure secondary mortgage market. Section 1322(b)(2)'s prohibition against any modification of home mortgage liens supports both mechanisms. Indeed, allowing modifications of home mortgages would seriously undermine the systems Congress has so effectively created.

A. The Section 1322(b)(2) Prohibition Against Modifying Home Mortgages is Consistent with Congress' Support for Home Mortgages via Mortgage Guarantees.

As early as 1934, when Congress passed the National Housing Act, Pub. L. No. 73-479, 48 Stat. 1246 (1934), establishing the Federal Housing Administration ("FHA"), Congress sought to make more home loans available by insuring home mortgages made by private lenders. During World War II, Congress again sought to make home financing available to more Americans by

establishing the Veteran's Administration (now Department of Veterans Affairs ("VA")) and the VA Home Loan Guaranty Program.

In essence, the mortgage insurance programs provide the mortgage borrower and lender with a substitute for the borrower's equity. If the borrower is not able to pay, the mortgage insurance program covers the lender's loss. The existence of these mortgage guaranty programs, therefore, has enabled private mortgage lenders to provide borrowers with loans requiring low down payments. Until Congress created the FHA Home Loan Mortgage Insurance Program, now operated by the Department of Housing and Urban Development, and the VA Home Loan Guaranty Program, mortgages were only available in amounts up to 75 or 80 percent of the value of the home, with the remaining balance of 20 to 25 percent being required as a down payment. With the use of the FHA and VA programs, and conventional (that is, non-governmental) mortgage insurance programs patterned after the FHA and VA programs, mortgages up to 95 percent of the home's value became common. Prospective home buyers who are unable to provide a 20 or 25 percent down payment may now become homeowners.

The success of these government programs is demonstrated by their growth. In 1992, FHA insured $48.3 Billion in mortgages, and by the end of 1992 there was $321.9 Billion in FHA-insured mortgages outstanding.[6] In 1992, the VA guaranteed $25.2 Billion in mortgages from

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[6] All data set forth in this brief is from information compiled by the Economics Department of the MBAA.

private lenders, and by the end of 1992 there was $159.6 Billion in outstanding VA guaranteed loans.

Each of the FHA and VA programs, however, share a common characteristic – they require the lender to liquidate the mortgage before the government will pay a claim for loss. VA Office of General Counsel Precedent 1-91, 56 Fed. Reg. 25,156 (June 3, 1991). This characteristic was present when section 1322(b)(2) was enacted and is present today.[7] If the Court allows modification to reduce the amount of the protection available to home mortgages, then the government will guarantee payment only to the extent of the *reduced* balance resulting from the modification. VA General Counsel Precedent 1-91.

Because modification will affect the government's guaranty at the expense of lenders, lenders must and will respond rationally to protect themselves from being undersecured. The most effective form of such protection will be to increase the down payments required to obtain home loans, especially in geographic areas of economic uncertainty. The result will be to frustrate the policy of and incentives included in Congress' home loan guaranty programs – to make home loans available to more Americans. If, however, section 1322(b)(2) is interpreted as the Fifth Circuit interpreted it, and as suggested by respondent and *amicus*, then Congress' policies and programs to foster housing will remain effective.

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[7] Testimony of Hon. Frank Keating, U.S. Department of Housing and Urban Development, June 6, 1991, at 4. A copy of Mr. Keating's testimony was filed with *amicus'* Fifth Circuit brief.

B. Section 1322(b)(2)'s Prohibition Against Modifying Home Mortgages is Consistent with Congress' Support for Home Mortgages via the Secondary Mortgage Market.

The secondary market for home mortgages also will be impaired if Chapter 13 modification of home mortgages is allowed in the manner advanced by petitioners. In the secondary market, mortgages are sold by mortgage bankers and other mortgage originators[8] into the nationwide (indeed, worldwide) capital markets to permanent investors. A significant aspect of the secondary mortgage market is the mortgage-backed security, which is based on pools of mortgages.

Congress, through several pieces of legislation, has fostered the growth of the secondary market. For example, in the Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 476 (1968), Congress authorized the new Government National Mortgage Association ("GNMA") to "guarantee the timely payment of principal and interest on such trust certificates or other securities as shall (i) be issued by . . . any . . . issuer approved . . . by the Association, and (ii) based on and backed by a trust or pool composed of mortgages. . . ." 12 U.S.C. § 1721(g)(1). GNMA's guaranteed mortgage-backed securities program began operating in 1970, and through mid-1992 GNMA had guaranteed over $423 Billion in securities based on and backed by pools of mortgages. The Federal National Mortgage Association

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[8] Mortgage originators bring the mortgage into existence after negotiating, arranging, and facilitating the making of a mortgage loan.

("FNMA" or "Fannie Mae") began issuing mortgage-backed securities in 1981. Through mid-1992, FNMA had issued over $413 Billion in securities based on and backed by mortgage pools. These mortgage-backed securities complemented the $98 Billion in mortgages held by FNMA in portfolio in 1992.

In 1970, Congress passed the Emergency Home Finance Act of 1970, Pub. L. No. 91-351, 84 Stat. 450 (1970), Title III of which created FHLMC (also known as "Freddie Mac"). Congress gave FHLMC authority to issue participation certificates based on and backed by pools of mortgages, and FHLMC began its Participation Certificate program in 1971. Through mid-1992, FHLMC had issued over $382 Billion in participation certificates based on and backed by mortgage pools. FHLMC held $28.6 Billion in mortgages in portfolio in 1992.

To facilitate the trading of mortgage-backed securities in the capital markets, Congress passed the Secondary Mortgage Markets Enhancement Act of 1984, Pub. L. No. 98-440, 98 Stat. 1689 (1984), which added an exemption to the restrictions on credit extension by securities dealers for a "mortgage related security." The Act defines a mortgage related security as including a security that "represents ownership of one or more promissory notes or certificates of interest or participation in such notes . . . which notes . . . are directly secured by a first lien on a single parcel of real estate . . . or on a residential manufactured home." 15 U.S.C. § 78c(a)(41).

In order to provide more flexibility in the issuance of mortgage-backed securities, Congress created the Real Estate Mortgage Conduit ("REMIC") in Section 671 of the

Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986). With regard to REMICs, the Act defines a "qualified mortgage" as "any obligation (including any participation or certificate of beneficial ownership therein) which is principally secured by an interest in real property. . . . " I.R.C. § 860G(a)(3)(A).

As in 1978 (when section 1322(b)(2) was enacted), today the home mortgage credit market relies heavily on the secondary market for mortgages. The size and importance of this efficient market is immense. In 1978, when the Bankruptcy Code was enacted, $742.8 Billion in home mortgages were outstanding. Of these mortgages, $65.4 Billion (8.8 percent) were in mortgage pools. In mid-1992, $2.9 Trillion in home mortgages were outstanding, of which $1.3 Trillion (44.8 percent) were in mortgage pools.

The secondary mortgage market and mortgage-backed securities have important benefits to prospective American homeowners. First, the secondary mortgage market enables economies of scale that, in turn, allow lenders to offer mortgages at rates and on terms that are comparable to those otherwise available only to large corporations. These attractive rates would not be available to individuals if the efficiency of the home finance credit markets were not present. Second, because of mortgage-backed securities encouraged by congressional legislation, mortgage bankers, and other mortgage originators, can access the investment capital market in dollar volumes far above the volumes that the capital of the mortgage banker ordinarily would support. The result of this increased access is that many more mortgage originators are available to make loans to individuals seeking to buy a home.

The secondary mortgage market and mortgage-backed securities will continue to offer advantages to the individual home buyer, however, only if a predictable flow of principal and interest from mortgages can be maintained. Only such a predictable flow can ensure securities issuers that they will meet their obligations to their investors – to provide both interest and principal on their investors' securities in full and in a timely manner, regardless of the performance of individual mortgages. Interpreting section 1322(b)(2) to prohibit any modification of home mortgages is a crucial aspect in ensuring the predictable flow of principal and interest from home mortgages. This is the only interpretation consistent with Congress' years of legislation tailored to foster mortgage-backed securities. If modification were allowed, then a significant element of uncertainty would be introduced into the mortgage credit market and the mortgage-backed security market would be considerably weakened.

CONCLUSION

Congress has enacted a pervasive and important legislative program to foster home mortgages and home ownership in America. Congress recognized the potential harmful impact on this program if modifications of home loans were allowed, and it provided special protection for home mortgages in the Bankruptcy Code. The only interpretation of Bankruptcy Code section 1322(b)(2) consistent with this congressional policy is the broad and full protection accorded by the court below – that a Chapter 13 debtor may not modify home mortgages by bifurcating those mortgages into secured and unsecured parts. For

the foregoing reasons, therefore, the Court should affirm the decision of the Court of Appeals for the Fifth Circuit.

Dated: February 22, 1993

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN and HARRIET NOBELMAN,

Petitioners,

v.

AMERICAN SAVINGS BANK,

Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Fifth Circuit

BRIEF OF AMICI CURIAE NATIONAL ASSOCIATION OF REALTORS® AND THE CALIFORNIA ASSOCIATION OF REALTORS® IN SUPPORT OF RESPONDENT

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On Writ of Certiorari to the United States
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BRIEF OF AMICI CURIAE NATIONAL ASSOCIATION OF REALTORS® AND THE CALIFORNIA ASSOCIATION OF REALTORS® IN SUPPORT OF RESPONDENT*

INTEREST OF AMICI

The NATIONAL ASSOCIATION OF REALTORS® [1] ("NAR") is a not-for-profit professional association com-

* All parties of record in this case have consented pursuant to Supreme Court Rule 36.1 to the filing of this *amicus curiae* brief in support of Respondent. These consents are filed herewith.

[1] The term "REALTORS®" is a federally registered collective membership mark used to identify members of the NATIONAL ASSOCIATION OF REALTORS®.

prised of approximately 750,000 persons engaged in all aspects of the real estate business.

NAR was created in 1908 to protect and promote private ownership of real property, to promote and encourage the highest and best use of land, and to advance professional competence in the rendition of real estate services. Through its many programs and the programs of its affiliated Institutes, Societies and Councils, NAR has been involved in matters of concern to home owners and other property owners for over three quarters of this century.

A member of NAR, the California Association of REALTORS® ("CAR") is a voluntary trade association whose members consist of local Boards of REALTORS® in California and those persons licensed by the state of California as real estate brokers and salespersons who are members of local Boards. There are 180 Boards of REALTORS® and over 120,000 individual members affiliated with CAR. CAR's mission is to serve its members by developing and promoting programs and services to enhance their ability to conduct their individual real estate businesses successfully, with integrity and competence.

NAR is the nation's largest trade association serving the real estate industry and CAR is the largest state trade association serving the real estate industry. As such, Amici and their members are greatly concerned with the interconnected matters of the availability and affordability of home ownership for as many Americans as possible. The decision in this case will have a significant impact on both availability and affordability of home ownership. Accordingly, Amici believe that they are uniquely positioned to recognize the seriousness of the threat to home ownership that would be posed by permitting the bifurcation of liens secured by the principal residences of debtors functioning under Chapter 13 of the Bankruptcy Code into a secured

portion equal to the market value of the residence and an unsecured portion equal to the balance of the indebtedness.

The reaction of lending institutions to such bifurcations will undoubtedly result in a decrease in the supply of responsible, affordable home mortgage financing; create a paucity in the availability of residential housing; dramatically curtail residential real estate transactions; and severely threaten the ability of many Americans to own their own homes. These are the inevitable products of permitting debtors functioning under Chapter 13 of the Bankruptcy Code to bifurcate a mortgage lien secured by their principal residence into secured and unsecured portions, and Amici strongly urge this Court to affirm the decision of the court below.

Amici do not propose to duplicate the legal arguments presented in the Respondent's brief. Rather, Amici endorse and urge to this Court the Statement of the Case and legal arguments set forth in that brief. Amici's intent in submitting this brief *amicus curiae*, is to add to the chorus of parties urging this Court to affirm the decision of the court below the voices of the hundreds of thousands of members of Amici and the Americans they serve, millions of current home owners as well as millions of Americans who hope that someday they too, will be able to participate in the American Dream by owning their own homes.

SUMMARY OF ARGUMENT

A significant negative impact on the availability of responsible, affordable home mortgage financing is the inevitable result should this Court allow the Petitioners to bifurcate the mortgage lien secured by their principal resi-

dence into a secured portion equal to the market value of the residence and an unsecured portion equal to the balance of the indebtedness (also referred to as a "cramdown"). Permitting cramdowns most likely would result in immediate, direct and serious losses to home mortgage lending institutions and would produce a correspondingly negative effect on the willingness of such lenders to finance future home mortgage loans. The severe repercussions for the entire real estate industry and for Americans who hope to purchase homes are obvious.

Cramdowns also would contravene the plain meaning of Section 1322(b)(2) of the Bankruptcy Code, which clearly protects mortgage lenders holding a lien secured by the debtor's principal residence from a bifurcation such as that proposed by the Petitioners. The plain language of §1322(b)(2) expressly states that the rights of lenders which are secured by things other than real property which is the debtor's principal residence may be modified and that the rights of home mortgage lenders are exempt from such modification. This means that the rights of holders of liens secured by items such as a vacation home or personal property may be modified. Cramdowns also would contravene the legislative intent underlying §1322(b)(2), namely, to offer special protection to home mortgage lenders under Chapter 13, in contrast to other types of creditors such as consumer loan creditors.

The purported conflict between §1322(b)(2) and §506(a) of the Bankruptcy Code is easily reconciled. The definition of a "claim" is set forth in §101(5)(A), which is part of the definitional section of the Bankruptcy Code. The definitions contained in that section apply to the rest of the Bankruptcy Code. It does not make sense to attempt to understand §1322(b)(2), especially its use of the word "claim", without reference to the definitional portion of the Code.

Cramdowns would have negative implications for the entire residential real estate industry and the hundreds of thousands of Americans who depend upon this vibrant industry for their livelihood, as well as all of the Americans who hope someday to participate in the American Dream of home ownership.

ARGUMENT

I.

CHAPTER 13 DEBTORS SHOULD NOT RECEIVE A WINDFALL AT THE EXPENSE OF THEIR LENDER AND FUTURE BORROWERS.

This case raises the question of whether debtors in a Chapter 13 bankruptcy case may bifurcate a lien secured by real property which is their principal residence into a secured portion equal to the then current market value of their residence and an unsecured portion for the balance of the indebtedness. This proposed bifurcation is commonly referred to as a "cramdown".

A particularly troubling aspect of mortgage cramdowns is that they do not provide a mechanism to address appreciation in the market value of the real property subsequent to the bifurcation of the lien. For example, where a Chapter 13 cramdown has been allowed and the real estate market subsequently improves, only the debtor benefits from the increased value of the residence. There is no way for the lienholder, whose lien has been bifurcated so that it is only secured up to an amount equal to the then current market value of the real property, to benefit from the appreciation of the property. Such a windfall to the debtor is both unfair and wholly at odds with the spirit

of Chapter 13 of the Bankruptcy Code. By enacting Chapter 13, Congress intended to improve creditor recoveries as well as debtor relief. *Collier on Bankruptcy* (15th edition) §1330.02.

Why should the debtor reap a benefit from bankruptcy that it otherwise would not enjoy? If a cramdown has been allowed, the lender already has been penalized once. Why should the lender be penalized yet again by the debtor receiving all of the benefits of an increase in the value of the residence while the lender, who made it possible for the debtor to purchase the home in the first place, is prevented from receiving any of the benefit from the increased value of the property?

Moreover, not only would it be the lenders unlucky enough to find themselves involved in Chapter 13 cramdowns which would be penalized by Chapter 13 debtors' receipt of windfalls; such windfalls would be at the expense of other potential home purchasers who will be penalized by the response of lenders to cramdowns in general by stiffening their lending requirements and increasing the costs associated with borrowing funds.

II.

SECTION 1322(b)(2) AND BANKRUPTCY POLICY IN GENERAL DO NOT MIMIC THE EFFECT OF FORECLOSURE, NOR SHOULD THEY.

One of the arguments advanced by the Petitioners in this case is that §1322(b)(2) replicates the effect of foreclosure. It is clear that the plain meaning of §1322(b)(2), which sets forth what a debtors' Chapter 13 Plan may contain, does not dictate or suggest the replication of the effect of foreclosure in Chapter 13 situations. The fallacy of Petitioners' position is that, if cramdowns are permitted

under §1322(b)(2), such modifications would *not* place the lender in the same position it would have been in had foreclosure taken place.

What this faulty analysis fails to take into consideration is that in many foreclosure situations, the lender recoups more than merely the amount realized from the sale of the real property, which amount often is much less than the amount due the lender pursuant to the loan. Frequently home mortgage lenders' losses due to foreclosures are reduced through insurance payments and the payment of postforeclosure claims. Polk, *The Chapter 13 Cramdown: New Nightmare for the Lender*, 19 *Real Estate Law Journal* 279, 292 (1991). The Petitioners' contention that the lender would be in an advantageous situation following a cramdown, or even in a situation comparable to that following foreclosure, is not convincing because it does not reflect what actually occurs in the marketplace.

If one were to accept the Petitioners' premise on this point, and if §1322(b)(2) were construed to replicate the effect of foreclosure, then in addition to holding a secured interest in the residence equal to its market value, the lender also should receive an amount equal to the insurance proceeds and any other payments it would have received had a foreclosure occurred. To do otherwise, and provide the lender with a security interest only equal to the market value of the property, unfairly would place the lender in a much less desirable position than it would have been in following a foreclosure.

Additionally, there is no principled reason to fashion bankruptcy policy merely to mimic the effect of foreclosure. A far better practice, and one in keeping with the spirit of Chapter 13, would be to provide for an exchange of benefits. This is because the debtor is permitted to retain

the residence, (and, incidentally, benefit from any post-bankruptcy appreciation in the value of the house, as discussed above) and the lender (which provided the funds to enable the debtor to purchase the home in the first place), ought to be permitted to retain its security interest in the home for the full amount of the loan. In this manner, the lender only would be able to benefit from its security interest in the real property if and when the debtor recovers from his or her financial difficulties or the real estate market recovers sufficiently to allow the lender to recover a greater portion of the loan amount through foreclosure.

III.

THE PROPER CONSTRUCTION OF AND CONGRESSIONAL INTENT UNDERLYING §1322(b)(2) ALSO REJECTS ALLOWING CRAMDOWNS.

Amici believe that an appropriate statutory analysis of §1322(b)(2) leads inescapably to the result that cramdowns are not intended in Chapter 13 of the Bankruptcy Code, as explained below.

A. The Plain Meaning of §1322(b)(2) of the Bankruptcy Code Prohibits Debtors From Modifying the Rights of Lenders Which Are Secured Only by Their Principal Residence.

Since *Nobelman v. American Savings Bank* is a Chapter 13 case, it is logical to begin with an examination of the portion of Chapter 13 itself, §1322(b)(2), which is applicable to this situation. On its face, §1322(b)(2) plainly and unequivocally forbids a Chapter 13 debtor from modifying the rights of lenders which are secured only by a mortgage lien on the real property which is the debtor's

principal residence. This is consistent with and advances Congress' intent to offer home mortgage lenders special protection in Chapter 13 cases.

The protection offered home mortgage lenders under Chapter 13 not only benefits lenders which find themselves involved with debtors who have filed for reorganizations under Chapter 13, but, as will be more fully explained later in this brief, the special protection §1322(b)(2) extends to home mortgage lenders benefits the entire residential real estate industry and potential home buyers. Home lenders require protection from the serious financial losses which inevitably would occur if cramdowns are permitted in Chapter 13 situations. Preservation of the affordability and availability of home mortgage financing, and consequently, the ability of consumers to purchase homes, likewise is virtually dependent on sound protection.

The Petitioners advance the notion that the protection afforded home mortgage lenders pursuant to §1322(b)(2) is limited by §506(a) of the Bankruptcy Code and a "secured claim" as described therein. Erroneously interpreting §1322(b)(2) in this manner, they claim that a lender's security interest in the residence should be reduced to an amount equal to the then current market value of the property. Amici urge the Court to note that it is only very recently that anyone has even questioned, much less suggested attacking, the protection so clearly afforded home mortgage lenders in §1322(b)(2).

The Petitioners' claim relies on the unfounded assumption that the words "secured claims" and the words "claim secured only by a security interest in real property" as used in §1322(b)(2), possess the same meaning. According to the plain language of §1322(b)(2), this assumption simply is not valid; these two non-identical phrases do not have

identical meanings. To interpret them as if they mean the same thing would remove from §1322(b)(2) the extremely important distinction it makes between claims which are secured **only** by the debtor's principal residence and those claims which are secured by items other than the debtor's principal residence.

To achieve this significant distinction, §1322(b)(2) employs the words "claim secured only by a security interest in real property . . ." (referred to as the "other than" clause) to limit the clause immediately preceding it. Thus, the "other than" clause explains that while the rights of a holder of a secured claim which is not secured by the debtor's principal residence may be modified, the rights of a holder of a claim for which the only security is the debtor's principal residence may **not** be modified. Unquestionably this means that the rights of holders of claims secured by something other than the debtor's principal residence, such as a vacation home or personal property, may be modified through the debtor's Chapter 13 plan. The purpose of the "other than" clause is straightforward; to explain that a lender's rights may not be modified by the debtor's Chapter 13 plan when the lender's only form of security is the debtor's principal residence.

The Petitioners' assumptions with regard to the interpretation of these clauses of §1322(b)(2) overlooks a basic common sense premise of statutory construction, namely, when interpreting the meaning of a word contained in a statute, one consults the definitional section of the statute for the meaning of the word. Section 101 is the definitional section of the Bankruptcy Code, and Section 103(a) of the Bankruptcy Code states that the definitions contained in Chapter 1 apply to cases under Chapter 13. Therefore, §101(5) provides the definition of the word "claim" for Chapter 13.

The relevant portion of §101(5) is as follows: " 'claim' means—(A) right to payment, whether or not such right is . . . secured or unsecured;". It is obvious from this definition that the word "claim" as used in §1322(b)(2) means both secured and unsecured claims. *See In re Etchin*, 128 B.R. 662, 667 (Bankr. W.D. Wisc. 1991). Accordingly, it is apparent that the operative word of the "other than" clause is the word "only".

The first clause of §1322(b)(2) articulates the concept that secured claims which are secured by property other than the debtor's principal residence may be modified. Once the definition of "claim" as set forth in the definitional section of the Bankruptcy Code is consulted, the next clause of §1322(b)(2), the "other than" clause, explicitly states that the rights of holders of secured or unsecured claims, the basis for the interest of which is the debtor's residence, may not be modified.

B. The Legislative History of §1322(b)(2) and Congressional Policy Regarding Home Mortgages are Consistent With the Position That Cramdowns Should Not Be Permitted In Chapter 13 Cases.

Where the meaning of a statute is not clear, it is proper to take policy considerations into account to assist in the interpretation of the statute. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 95 S.Ct. 1917, 1926 (1975) and *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 1031 (1989). In its enactment of §1322(b)(2), Congress obviously intended to offer home mortgage lenders special protection from cramdowns. Congress overwhelmingly has encouraged affordable and readily available home mortgage financing, as demonstrated by Congress' establishment of effective programs through which the federal government guarantees home mortgages,

and by the establishment of an active secondary mortgage market.

For example, Congress established both the Federal Housing Administration and the VA Home Loan Guaranty Program to insure home mortgage financing made available through private lending institutions. Through both of these successful programs, Congress has enabled many Americans to obtain mortgage financing and purchase homes with very small down payments. To fulfill Congress' objective to make home mortgage financing available to as many Americans as possible, the Petitioners' strained construction of §1322(b)(2) to permit cramdowns must be rejected.

Under both of these programs, in order for a lender to recover on a defaulted loan, the lender first must liquidate the mortgage. If cramdowns are allowed in Chapter 13 cases, most likely the government only would guarantee payment on the secured amounts as reduced through the bifurcation. Lenders obviously would need to protect themselves from such reductions in governmental guarantees, and they almost certainly would do so by increasing the amount of down payments they require. This would thwart the Congressional purpose underlying the provision of governmental guarantees in the first place, namely making home financing and therefore, home ownership, available to as many Americans as possible.

The stability of the secondary mortgage market is an additional concern. Thanks to the secondary mortgage market and mortgage-backed securities, more Americans are able to obtain home financing with rates and on terms that approach those available to corporate entities. If cramdowns are permitted, payments on the underlying mortgages over the life of the loans would be decreased and the secondary mortgage and mortgage-backed security

markets would be threatened seriously. As a result, Congressional intent would be frustrated and the American consumer would suffer.

Further revealing Congressional intent with respect to Chapter 13 and the protection afforded home mortgage lenders thereunder is a discussion with respect to Chapter 12 and farm reorganizations. In a discussion regarding what may be accomplished in a plan, Congress stated "What may be in a plan comes from both Chapter 13 and Chapter 11. In Chapter 13 a debtor may not modify the mortgage on his residence (§1322(b)(2))—that provision was omitted and the debtor would be able to rearrange his home mortgage in Chapter 12 just as he can in Chapter 11." 132 Cong. Rec. §5448 (Wednesday, May 7, 1986).

IV.

PERMITTING BIFURCATIONS UNDER CHAPTER 13 OF THE BANKRUPTCY CODE WOULD HAVE SERIOUS NEGATIVE IMPLICATIONS FOR FUTURE RESIDENTIAL REAL ESTATE FINANCING AND FOR THE ENTIRE REAL ESTATE INDUSTRY AS WELL AS PRECLUDE MANY FINANCIALLY RESPONSIBLE AMERICANS FROM OWNING THEIR OWN HOMES.

If this Court allows the cramdown proposed by the Petitioners in this case, other similarly situated debtors would be encouraged to seek such modifications of the loans secured by their residences. Such a decision might even encourage more individuals to file for reorganization under Chapter 13 of the Bankruptcy Code. Ever increasing numbers of individuals already are filing for such reorganizations. Even during the relatively strong economic times of the late 1980's, the number of bankruptcy filings continued to increase, and as the stigma attached to filing for bankruptcy continues to disappear, it is only logical

to assume that even greater numbers of individuals will seek bankruptcy protection. Polk, at 280. Amazingly, in 1989, one out of every 138 American households was in bankruptcy. *Id.*

Permitting cramdowns under Chapter 13 would cause home mortgage lending institutions to suffer immediate, direct and serious losses. Understandably, this would produce a correspondingly negative effect on the willingness of such lenders to finance future home mortgage loans and to refinance existing home mortgage loans. This reluctance most likely would be felt to the greatest degree in those parts of the nation where the market values of homes are expected to continue to decline and where the economy is expected to continue to languish. Lenders in those parts of the country understandably would feel particularly susceptible to Chapter 13 bankruptcy filings, cramdowns and the resulting losses inherent in cramdowns. The response of lending institutions to cramdowns will impact most severely potential home buyers on the margin of mortgage lending requirements. Lenders would be unwilling to supply mortgage financing to numerous individuals who would qualify for financing today.

In addition, permitting cramdowns could result in serious negative implications for American consumers in general as well as for the residential real estate industry and the hundreds of thousands of Americans who depend upon that industry for their livelihood. The potential threats to consumers include a decrease in the availability of home mortgage loans and increased costs associated with such loans in the form of higher interest rates, larger down payment requirements and increased application fees. Thus, many Americans who qualify for a loan will find it nevertheless more expensive to own their own home. Many other individuals could be precluded from selling their existing homes (already a difficult proposition in much of the country) as potential purchasers become unable to obtain affordable mortgage financing; still other individuals could be prevented from refinancing their homes.

CONCLUSION

Permitting cramdowns under Chapter 13 of the Bankruptcy Code would have serious negative implications for future residential real estate financing and therefore, for the residential real estate industry as well as for Americans who hope to purchase homes. Section 1322(b)(2) clearly exempts home mortgage lenders from cramdowns, and the intention of Congress is to encourage affordable and readily available home mortgage financing by protecting home mortgage lenders through the enactment of §1322(b)(2). Amici urge this Court to give vitality to Congress' objective by prohibiting Chapter 13 cramdowns.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,
Petitioners,

VS.

AMERICAN SAVINGS BANK,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF AMERICAN BANKERS ASSOCIATION, AMERICAN FINANCIAL SERVICES ASSOCIATION, AND CREDIT UNION NATIONAL ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF THE RESPONDENT

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BRIEF OF AMERICAN BANKERS ASSOCIATION, AMERICAN FINANCIAL SERVICES ASSOCIATION, AND CREDIT UNION NATIONAL ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF THE RESPONDENT[1]

INTEREST OF *AMICI CURIAE*

If the decision of the United States Court of Appeals for the Fifth Circuit below were to be reversed, it would have a significant impact on the mortgage lending practices of innumerable financial institutions throughout the United States. The three *amici* who have joined to submit this brief in support of

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[1] Letters indicating the consent of all parties to the filing of this brief have been filed with the Clerk.

dent American Savings Bank are all trade associations whose constituent memberships comprise a significant portion of those financial institutions.

The American Bankers Association ("ABA") is the principal national trade association of the commercial banking industry in the United States. It has members in each of the fifty states and the District of Columbia, and its membership includes banks of all sizes and types – national and state, money-center, regional and community banks, independent and bank holding company owned banks. ABA member banks hold over ninety percent of the assets of the banking industry in this country. The ABA frequently appears in litigation as a party or as amicus curiae in cases of widespread importance to the industry at large.

The American Financial Services Association ("AFSA") is the nation's largest trade association representing non-bank providers of consumer financial services. Organized in 1916, AFSA represents 367 companies operating 10,910 offices engaged in extending over $200 billion of consumer credit throughout the United States. These companies range from independently-owned consumer finance offices to the nation's largest financial services, retail and automobile companies. Retail and automobile credit is extended through thousands of stores and dealers. Consumer finance companies hold over $150 billion of consumer credit outstanding and $67 billion in second mortgage credit representing one quarter of all consumer credit outstanding in the United States. Accordingly, AFSA has a vital interest in consumer bankruptcy.

Credit Union National Association ("CUNA") is the principal national trade association for credit unions in the United States. CUNA's direct membership consists of fifty-two credit union leagues covering the fifty states, the District of Columbia, and Puerto Rico. In turn, just over 90 percent of the approximately

13,800 credit unions in the United States are affiliated with CUNA through membership in CUNA's member leagues.

SUMMARY OF ARGUMENT

The clear meaning of § 1322(b)(2) of Title 11 United States Code ("Bankruptcy Code") is that loans secured by no collateral except mortgages on a debtor's home cannot be modified in Chapter 13. The only relevant inquiry is whether the creditor's claim is secured only by a security interest in the debtor's principal residence. There is no other qualification: the protection is not limited to first mortgage loans; it is not limited to the amount of the allowed secured claim; it does not exclude liens that exceed the value of the collateral; and it is not limited to mortgages on homes without fixtures, carpet, or insurance.[2]

Sections 506(a) and 1322(b)(2) do not permit "lien splitting" or "lien stripping" of residential mortgages in Chapter 13 bankruptcy cases. Bankruptcy Code § 506(a) is not a lien modification ("cramdown") provision. Rather, § 506(a) bifurcates bankruptcy claims for certain purposes, such as determining the extent of an undersecured creditor's share of the distribution to unsecured creditors. Section 506(a) does not affect liens, which flow through bankruptcy unless modified pursuant to a confirmed plan in Chapter 11, 12, or 13. Section 1322(b)(2) allows cramdown in a Chapter 13 plan, but expressly excludes from this authority any lien on the debtor's principal residence. The rights of holders of claims secured solely by liens on the debtor's residence cannot be modified in a Chapter 13 plan. Under the plain meaning of § 1322(b)(2), such holders are entitled to full payment or to enforce their liens by foreclosure.

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[2] This is the suggestion in strained cases like *Sapos v. Provident Institution of Savings in the Town of Boston*, 967 F.2d 918 (3d Cir. 1992) and *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990).

Dewsnup v. Timm, 502 U.S. ___, 112 S.Ct. 773 (1992), is the latest in a strong line of United States Supreme Court decisions that has explained the relationship between § 506(a) and the specific Bankruptcy Code cramdown provisions. The basic explanation in *Dewsnup*, regarding the fundamental structure of the Bankruptcy Code and its effect on liens as *in rem* interests unaffected by § 506(a), is dispositive and cannot simply be ignored in this case. In contrast, post-*Dewsnup* decisions by the United States Courts of Appeals for the Second, Third and Ninth Circuits have failed to confront the reasoning in *Dewsnup* and the role of that case in explaining the basic structure of the Bankruptcy Code with respect to the treatment of liens. As a result, these cases do not properly interpret the Bankruptcy Code and should be rejected. Clearly, there is no basis in the Bankruptcy Code or its legislative history for allowing use of § 506(a) as a cramdown provision to modify liens in a proceeding under any chapter of the Bankruptcy Code.

ARGUMENT

I. The Plain Meaning of Bankruptcy Code Section 1322(b)(2) Precludes Any Cramdown of Home Mortgage Loans in Chapter 13 Cases

A. *General Discussion*

The plain meaning of a statute, such as § 1322(b)(2), should be conclusive, except in the rare case in which the literal application of the statute would "produce a result demonstrably at odds with the intention of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)). Thus, the

plain meaning of § 1322(b)(2) prohibits modification of the "rights" of the "holder" of a "claim" secured solely by a debtor's residence. The term "claim" includes secured and unsecured claims.[3]

The United States Court of Appeals for the Second Circuit in *Bellamy v. Federal Home Loan Mortgage Corporation* attempted to dismiss the plain meaning of § 1322(b)(2) by looking around the meaning of the actual words of the prohibitory language itself, and instead analyzing the location of such language in relation to other words and phrases of that subsection. *Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176, 180-81 (2d Cir. 1992). This attempt evades the plain issue under § 1322(b)(2), which is whether respondent is a holder of a claim secured only by an interest in the petitioners' residence.[4] Moreover, this is clearly contrary to the teaching of *Dewsnup* that, in a complex statute, one must exercise care not to place excessive emphasis on the location of a phrase with clear meaning, within the structure of a multi-faceted sentence or statutory provision. To do so in this case, as a means to override the plain meaning of the clause protecting home mortgage lenders, would make a mockery of statutory interpretation.

Essentially, petitioners seek to avoid this plain meaning and utilize § 506(a) as an independent cramdown statute, thereby reducing home mortgage loans to the actual value of the residence itself. Contrary to the argument of the petitioners, § 1322(b)(2) protects all claims which are secured only by liens against homes, *not* merely the amount of an allowed secured

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[3] The term "claim" is defined in the definitional provisions at 11 U.S.C. § 101(5), not § 506(a).

[4] *See In re Boullion*, 123 B.R. 549 (Bankr. W.D. Tex. 1990); *Matter of Kaczmarczyk*, 107 B.R. 200 (Bankr. D. Neb. 1989); *In re Russell*, 93 B.R. 703, 705 (D. N.D. 1988).

claim, a term used for other purposes in § 506(a). There is no apparent connection between the language of § 506(a) recognizing the secured and unsecured portions of an allowed claim for the purposes of that section, and the cramdown provision at § 1322(b)(2) that specifically protects from modification the rights of any holder of a claim secured solely by a mortgage on the debtor's residence.

Moreover, the language used in §§ 506(a) and 1322(b)(2) is significantly different. The term "allowed secured claim" is used in § 506(a) while the language "a claim secured only by a [home mortgage]" is used in § 1322(b)(2). Additionally, the different terminology appears in two very different chapters of the Bankruptcy Code, in sections that have entirely different purposes.[5] An attempt to meld these sections together so as to make § 506(a) an independent cramdown provision overriding the plain and simple meaning of the protective language at § 1322(b)(2) requires a leap of faith that is nowhere justified in the language of the statute or the legislative history.

In *Dewsnup v. Timm*, 502 U.S. ___, 112 S.Ct. 773 (1992), this Court rejected efforts of the debtor similarly to meld together unrelated language with different purposes in § 506(a) and (d).[6] The language in §§ 506(a) and 1322(b)(2) is far less similar and is farther removed, both in terms of physical location and appar-

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[5] *See infra*, Part II.

[6] As noted in the *amici* brief (at page 25), "[t]he issue in *Dewsnup* was whether a chapter 7 debtor could use §§ 506(a) and 506(d) to strip down a lien." More specifically, the issue was whether § 506(a) could be used to bifurcate the lien for purposes of cramdown, as opposed to merely establishing the amounts of the secured and unsecured claims for other purposes. The Court responded in *Dewsnup* that § 506(a) does not serve to bifurcate the claim for puposes of cramming down the lien, which survives as an *in rem* interest that flows through a bankruptcy (unless, of course, crammed down pursuant to a specific provision in Chapter 11, 12 or 13). Yet the petitioners in this case are seeking to use § 506(a) in precisely that manner, as a cramdown provision.

ent purpose, as compared to § 506(a) and (d). Furthermore, if petitioners' analysis is correct, the language of § 506(a) is irreconcilable with the plain meaning of § 1322(b)(2), as well it should be. The two subsections have two entirely different purposes, i.e., determining distributions to unsecured claims as opposed to lien modification. The Bankruptcy Code prescribes a different approach for each purpose. Thus, the petitioners' argument in this case is far weaker than that of the debtor in *Dewsnup*.

Application of § 506(a) to modify the lien, where the value of the collateral is less than the debt, would modify the rights of the holder of a claim secured only by a security interest in the principal residence of the debtor, as clearly barred by § 1322.[7] Under § 1322, the only permissible modification of a claim secured by a residential mortgage is the curing of default and the reinstatement of regular installment payments under § 1322(b)(5).[8]

The obvious meaning of § 1322(b)(2) is that claims with no collateral other than mortgages on the debtor's home cannot be modified in a Chapter 13 case. There are evident societal reasons for this treatment. The very lenient terms available to borrowers on home mortgage loans, in comparison to other forms of consumer credit, reflect the societal expectation that

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[7] *See e.g., In re Chavez*, 117 B.R. 733 (Bankr. S.D. Fla. 1990); *In re Boullion*, 123 B.R. 549 (Bankr. W.D. Tex. 1990); *In re Russell*, 93 B.R. 703 (D. N.D. 1988); *In re Catlin*, 81 B.R. 522 (Bankr. D. Minn. 1987); *In re Hynson*, 66 B.R. 246 (Bankr. D. N.J. 1986), rejected by *In re Harris*, 94 B.R. 832 (D. N.J. 1989); *In re Simpkins*, 16 B.R. 956 (Bankr. E.D. Tenn. 1982).

[8] *See e.g., In re Sauber*, 115 B.R. 197 (Bankr. D. Minn. 1990); *Matter of Kaczmarczyk*, 107 B.R. 200 (Bankr. D. Neb. 1989).

mortgages on the debtor's home create a legally safe and secure investment vehicle. The entire mortgage finance system in the United States is built on this premise.[9]

Furthermore, the Chapter 13 cramdown provision[10] offers creditors few of the traditional safeguards built into the equivalent Chapter 11 provision,[11] apparently because the types of consumer credit and collateral most often subject to cramdown under § 1322(b)(2) involve relatively small sums of money and therefore do not warrant expensive and time-consuming proceedings such as those under § 1129. In contrast, mortgage loans on the debtor's home typically represent sizeable, carefully negotiated transactions involving liens on a valuable asset that has the potential to appreciate in value. There is no precedent in either the Bankruptcy Code or the legislative history for allowing the debtor to restructure this kind of security arrangement unilaterally for his or her sole benefit, at the expense of the other contracting parties.

The significant exception to this rationale was *National Life Insurance Co. v. Pinegate Associates, Ltd.*, 2 B.C.D. 1478 (Bankr. N.D. Ga. 1976), where the debtor crammed down a multifamily real estate mortgage loan during a period of depressed property values in order to impose the loss on the secured creditor, while retaining for the debtor the potential for future appreciation in value. This is precisely what the petitioners in this case are seeking to do. The response to *Pinegate* was enactment of 11 U.S.C. § 1111(b), de-

[9] *See generally, In re Hemsing*, 75 B.R. 689 (Bankr. D. Mont. 1987); *In re Hynson*, 66 B.R. 246 (Bankr. D. N.J. 1986) rejected by *In re Harris*, 94 B.R. 832 (D. N.J. 1989).

[10] 11 U.S.C. § 1322(b)(2).

[11] 11 U.S.C. § 1129.

signed to prohibit this outcome in Chapter 11 cases.[12] The petitioners now seek to resurrect *Pinegate* in the context of home mortgage debt under the guise of the statutory language of § 506(a), when § 1322(b)(2) was clearly designed to do just the opposite.

This use of § 506(a) was specifically rejected in *Dewsnup*, when this Court noted that:

> The practical effect of petitioner's arguments is to freeze the creditor's secured interest at the judicially determined valuation. By this approach, the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale. The increase would accrue to the benefit of the debtor, a result some of the parties describe as a "windfall."
>
> We think, however, that the creditor's lien stays with the real property until the foreclosure.

Dewsnup, 112 S.Ct. at 778.

Consequently, § 1322(b)(2) is to be read in accordance with its plain meaning, which precludes modification of home mortgage liens.

B. *Response to Amici*

In their *Amici Curiae* brief in support of the petitioners (hereinafter "the *amici* brief"), *amici* David S. Yen, Gary Klein, Daniel L. Haller and Lawrence Young (hereinafter the *"amici"*) begin with the proposition that the plain language of § 1322(b)(2) indicates

[12] For an explanation of 11 U.S.C. § 1111(b), see Robin E. Phelan and Mark X. Mullin, *How Much is That Doggie In The Window: Valuation Issues in Bankruptcy*, 46 Consumer Fin. L. Q. Rep. 107, 128 (1992).

that it protects only the amount of the secured creditor's lien after cramdown under § 506(a). However, by its terms, § 1322(b)(2) protects "the rights of holders . . . of a claim secured only by" a lien on the debtor's home. As this Court noted in *Johnson v. Home State Bank*, 501 U.S. ___, 111 S.Ct. 2150, 2153-54 (1991), a mortgagee's "rights" include the right to payment of the debt and, upon the discharge of the debtor's personal liability, the right to foreclose on the mortgage.[13] Thus, it would appear that a focus on the rights of the creditor, as opposed to the status of the claim, is clearly present in § 1322(b)(2). Of course, the language preferred by the *amici* would not have been used, because it is not the approach of the Bankruptcy Code to refer to a "creditor secured by a lien." The *amici's* other references to "creditors" in the Bankruptcy Code[14] refer to the claims of creditors, not their liens. Section 1322(b)(2) clearly protects the rights of certain creditors to enforce such liens regardless of how their claims are classified.

The further argument of the *amici* that home mortgages should be subject to cramdown because "[n]othing in § 1322(b)(2) states that § 506(a) does not apply" again requires one to assume that Congress used this subtle omission to change the basic and historic relationship between bankruptcy claims and *in rem* liens, and that the failure of Congress to foresee the very creative arguments in the *amici* brief and to address them specifically in the statute means that the *amici* must be correct. The view of the *amici* would require a very prescient Congress indeed.

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[13] *See also In re Etchin*, 128 B.R. 662, 667 (Bankr. W.D. Wis. 1991) (rights of holders of secured claims "include the right to credit bid with the unsecured portion of the debt at a foreclosure sale or otherwise to avail themselves of benefits from appreciation in the value of the property").

[14] See references cited in the *amici* brief, p. 22.

II. The Basic Structure Of The Bankruptcy Code Is Inconsistent With The Use Of Section 506(a) As A Cramdown Provision

A. The Bankruptcy Cramdown Provisions

The Bankruptcy Code contains three chapters designed to enable the debtor to restructure his or her debts: Chapters 11, 12, and 13. Each of these contains a "cramdown" provision[15] allowing a debtor, without the consent of the secured creditor, to restructure secured debt in a bankruptcy plan by stripping from the lien the amount of debt in excess of the value of the collateral. Otherwise, the lien would flow through bankruptcy unimpaired by the discharge of the debtor's personal liability, under 11 U.S.C. § 524(a)(1). *See e.g., Dewsnup*, 112 S.Ct. at 777-78 (noting and affirming the long-standing rule that "liens pass through bankruptcy unaffected").

Thus, a debtor seeking to cram down secured debt must proceed under § 1129(b), § 1222(b)(2), or § 1322(b)(2). There is no equivalent in Chapter 7 because that chapter is designed to liquidate, and not restructure, the debtor's assets and liabilities. When debtors sought to use Bankruptcy Code § 506(a) as an independent cramdown provision in Chapter 7 cases, this Court properly rejected such a notion. Specifically, this Court in *Dewsnup*, recognized that liens can be restructured only pursuant to a specific cramdown provision in a designated reorganization proceeding, and not by use of general administrative provisions such as § 506(a). *Dewsnup*, 112 S.Ct. at 778-79.

This result is consistent with the basic structure of the Bankruptcy Code. If § 506(a) were an independent cramdown provision, as the petitioners argue, there would be no need for §§ 1129(b), 1222(b)(2), and 1322(b)(2), or indeed for Chapters 11, 12, and 13 at all,

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[15] 11 U.S.C. §§ 1129(b), 1222(b)(2) and 1322(b)(2).

except possibly to escape the effects of *Dewsnup* in Chapter 7.[16] All reorganizations, family farmer arrangements, and individual debtor plans could be structured using only § 506(a). The United States Court of Appeals for the Second Circuit in *Bellamy* essentially takes the position that this is what Congress intended and that the purpose of § 1322(b)(2), and presumably, by analogy, §§ 1129(b) and 1222(b)(2) as well, is simply to protect the creditor against a reduction in the monthly installment payments on the remaining loan balance. *Bellamy*, 962 F.2d at 184-185. This position cannot be supported when viewed in the context of the role of § 506(a), and would trivialize the Bankruptcy Code's elaborate and very specific cramdown provisions.

In *Dewsnup*, this Court correctly recognized that § 506(a) is not a definitional provision for purposes of restructuring secured debt. As noted above, arguments to the contrary would render § 506(a) the preeminent Bankruptcy Code cramdown provision, in derogation of the carefully crafted scheme of Chapters 11, 12, and 13. This would turn on its head the basic principle of statutory construction, that a specific provision, such as § 1322(b)(2), controls over those of a general nature such as § 506(a).[17] Thus, even if § 506(a)

[16] The *amici* argue that bifurcation of home mortgage liens under § 506(a) would operate independently of § 1322(b)(2) and therefore would not violate the § 1322(b)(2) restriction on modification in the plan. *See* the *amici* brief, pps. 37-38. Contrary to this reasoning, it is clear that the bankruptcy court's authority to modify liens in Chapter 13 cases is derived from § 1322(b)(2), which expressly grants that authority, subject to the exception for home mortgage liens. The argument in the *amici* brief, that a § 506(a) cramdown would leave the lien unaffected by the Chapter 13 plan (*see* the *amici* brief, pps. 38-39), illustrates precisely how this view would render as surplusage the procedures in Chapters 11, 12, and 13 that were intended by use of a confirmed plan to be the mechanisms for restructuring secured debts.

[17] *See In re Mitchell*, 125 B.R. 5, 6 (Bankr. D. N.H. 1991); *In re Boullion*, 123 B.R. 549, 550 (Bankr. W. D. Tex. 1990) and cases cited therein; *see also In re Sauber*, 115

were a cramdown provision, which it clearly is not, § 1322(b)(2) would stand as a specific exception to the general rule of § 506(a).

B. Legislative History

The *amici* brief cites extensively from the House Report relating to treatment of liens.[18] This language is mainly general in nature and refers to the basic approach in the Bankruptcy Code of bifurcating undersecured claims for purposes of determining the extent of adequate protection needed and for other such general matters. This general language is not helpful with regard to cramdown of liens, as it discusses the treatment of liens as a general concept and does not relate to specific protective provisions such as §§ 1111(b) and 1322(b)(2).

Nonetheless, the *amici* brief derives from this general language the conclusion that § 506(a) "imports into virtually every aspect of bankruptcy law the economic reality of what a security interest is actually worth."[19] *Dewsnup* specifically rejected the argument that general provisions in Chapter 5 of the Bankruptcy Code necessarily control every issue regardless of the context.

Further language in the *amici* brief, at pages 32-33 (quoting again from the House Report), refers to the effect of § 506(a) in establishing the unsecured claim of an undersecured creditor for purposes of receiving

B.R. 197, 199 (Bankr. D. Minn. 1990) ("The application of general concepts is not universal in the scheme of the [Bankruptcy] Code, but is subject to specific limitation, and even total disregard, in some instances").

[18] *See* the *amici* brief, pps. 27-33, citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977).

[19] *See* the *amici* brief, p. 30.

payment with general unsecured creditors. There can be no doubt that this is precisely the purpose of § 506(a), and that this unsecured claim exists quite apart from the undersecured creditor's *in rem* lien rights, which, as noted, flow through bankruptcy subject to the specific cramdown provisions in Chapters 11, 12, and 13.

As the House Report further notes,[20] this was intended to reject prior decisions that gave the undersecured creditor a full secured claim for the total debt as against the distributable assets of the bankruptcy estate "in preference to all unsecured creditors". Thus, the House Report makes clear that § 506(a) relates only to claims against the estate, and does not purport to terminate the *in rem* interest represented by the lien, which, as recognized in *Dewsnup*, continues to flow through bankruptcy. In a Chapter 13 case, this *in rem* interest, the lien, can be terminated only under § 1322(b)(2), subject to the limitation that protects liens on the debtor's residence.

It is true, as noted in Senate Report No. 989,[21] that the Bankruptcy Code refers, for the most part, to claims and not creditors, though this in no way supports the *amici* argument that § 506(a) is the primary Bankruptcy Code cramdown provision. The language at § 1322(b)(2) is quite clear in protecting any "claim" secured solely by a lien on the debtor's residence, and other language in § 1322(b)(2) focuses on protecting the "rights" of the "holder" of such a claim. Thus the pertinent language in § 1322(b)(2) makes clear that its protection is not limited to a narrow definition of "secured claim," even if that term was defined elsewhere for purposes of cramdown.

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[20] *See* the *amici* brief, p. 33.

[21] *See* the *amici* brief, p. 41, citing S. Rep. No. 989, 95th Cong. 2d. Sess. 68 (1978).

C. The Potential Impact of *Dewsnup* in Chapter 11 Cases

(i) *General Impact*

It has been argued that the *Dewsnup* view of § 506 should be limited to Chapter 7 cases, because of the additional problems that this rationale would cause in Chapter 11 cases.[22] While the case at bar arises under Chapter 13, an analysis of this argument is relevant to a determination of the proper relationship between § 1322(b)(2) and § 506(a). A careful analysis of this issue reveals that such arguments are based on an incorrect interpretation of both *Dewsnup* and Chapter 11.

The argument that applying *Dewsnup* in Chapter 11 cases would upset the treatment of subordinate liens that are subject to prior liens exceeding the value of the collateral is based on false assumptions. *Dewsnup* does not distinguish between liens that are covered by valuable collateral and those that are not. A lien simply flows through Chapter 7 regardless of the value of the collateral. The amici brief contends that this interpretation would allow a junior lienor to disrupt agreements between the debtor and a prior lienor designed to allow the debtor to retain the property by continuing to make payments to the prior lienor. However, this contention simply reflects the inherent character of any junior lien, in or out of bankruptcy: such lienor is entitled to assert its legal rights until the lien is extinguished by foreclosure or is treated in a confirmed bankruptcy plan.

In a Chapter 11 case, the subordinate lienor is allowed to participate as an unsecured creditor in confirmation of the plan pursuant to § 1129(a) or pursuant to cramdown under § 1129(b), while retaining the lien subject to § 1129(b)(2)(A)(i)(I). The result is

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[22] *See e.g.*, Margaret Howard, *Dewsnupping the Bankruptcy Code*, 1 J. Bankr. L. and Prac. 513, 517-18 (1992).

similar in Chapter 13. The argument that subordinate liens should be stripped away under § 506(a), merely because of the possibility that a subordinate lienor may have an improved bargaining position as compared to unsecured creditors, represents an extraordinary approach to bankruptcy, in which fundamental, negotiated rights are suddenly deemed to be terminated because of the possibility that a creditor might benefit as a result of those rights.[23]

The very weaknesses of the arguments seeking to impair the viability of *Dewsnup* outside of Chapter 7, by considering its implications for Chapter 11 cases, actually suggest that the *Dewsnup* rationale is appropriate in Chapter 11 and 13 cases.

(ii) Impact of § 1111(b)

The *amici* specifically argue that Congress created an express limitation on cramdowns in Chapter 11 cases, at § 1111(b),[24] and therefore could have done the same for holders of residential mortgages in Chapter 13 if that was intended.[25] The simple answer is that Congress did exactly that in § 1322(b)(2).

The more extensive language of § 1111(b) is required because Chapter 11 contains much more elaborate secured creditor protections and calls for greater creditor participation in confirmation of the

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[23] Moreover, in such cases the subordinate lienor has no incentive to interfere with a continuation of payments to the prior lienor. Indeed, the subordinate lienor is benefited to the extent the prior lien is reduced, and normally can be expected to encourage rather than discourage such arrangements.

[24] As noted *supra* at Part I, Congress enacted § 1111(b) in response to *National Life Insurance Co. v. Pinegate Associates, Ltd.*, 2 B.C.D. 1478 (Bankr. N.D. Ga. 1976), where the court allowed the debtors to do essentially the same thing that the petitioners in this case are seeking. Congress clearly perceived this as an abuse, and § 1111(b) was enacted to reject *Pinegate*. Language to the same effect was included in § 1322(b)(2) for the same apparent purpose.

[25] *See amici* brief, pps. 22-24.

plan, than does Chapter 13. In Chapter 13, the unsecured claim is important only for participating in distributions under the plan. Recognizing that an undersecured home mortgage lender's lien will flow through bankruptcy unmodified under § 1322(b)(2), the only remaining issue is the extent to which the unsecured claim is entitled to payment under §§ 506(a), 1322(a), and 1325(b). There is no need to mention payments under the plan in § 1322(b)(2), which deals with a different issue, the *in rem* lien.

In contrast, Chapter 11 contemplates extensive creditor involvement in formulation and confirmation of the plan, based in part on the amount of unsecured claims.[26] These provisions enable the debtor to modify a secured claim, but only upon meeting certain requirements.[27] Section 1111(b) permits the secured creditor to achieve immunity to such modification or cramdown, if, in turn, the creditor is willing to relinquish its unsecured claim under § 506(a) and forego its participation in confirmation of the plan. This allows the undersecured creditor to opt out of the plan, despite § 506(a), which is the reason for inclusion in § 1111(b) of the reference to § 506(a).

In effect, Chapter 11 gives the undersecured creditor the option either to retain the unsecured claim recognized at § 506(a) for purposes of participating in confirmation of the plan and risk a cramdown of the lien under § 1129(b), or relinquish the unsecured claim and its attendant voting rights under Chapter 11 and rely solely on the lien, which thereby is given immunity from cramdown.

In contrast, the undersecured creditors in Chapter 13 have no voting rights and do not significantly participate in formulating or confirming the plan of reor-

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[26] *See e.g.*, 11 U.S.C. §§ 1102, 1103, 1126, 1129.

[27] *See e.g.*, 11 U.S.C. § 1129(b).

ganization. Thus, there are no such rights to relinquish, and no need to refer to § 506(a). Furthermore, the immunity from cramdown at § 1322(b)(2) is limited to a single class of claims and is automatic. All of this reflects the highly simplified nature of Chapter 13 in comparison to Chapter 11, as befits the purpose of each. The home mortgage lender is protected by § 1322(b)(2) because of the nature and societal importance of home mortgage credit, which extends beyond the new home purchase to home improvement and construction loans.

D. Impact of *Dewsnup* in Chapter 13 Cases

Several additional *Dewsnup* "problems" have been asserted in the specific context of Chapter 13 cases. One is the argument that precluding cramdown under § 506(a) will mean that Chapter 13 debtors will only be able to cram down secured debt within the limitations of the specific Chapter 13 cramdown provision at § 1322(b)(2). This, of course, is only a "problem" if one is dissatisfied with the statutory language at § 1322(b)(2) and is seeking to override its limitations by judicially creating a new cramdown provision at § 506(a).

Another argument is that this recognition of the true meaning of § 1322(b)(2) somehow prevents a debtor from saving his or her home. This argument fails for three reasons. First, § 1322(b)(2) does not prevent the debtor from curing any default so as to stop an impending foreclosure,[28] and the automatic stays at § 362 and § 1301 provide extra breathing room to enable a debtor to effectuate this cure. These are the true keys to saving a debtor's home in Chapter 13, not § 1322(b)(2).

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[28] *See* 11 U.S.C. § 1322(b)(5).

Second, those courts that have allowed cramdown of home mortgage debt under § 506(a) in Chapter 13 cases typically have concluded that the residual effect of § 1322(b)(2) is to preclude reduction of the debtor's monthly installment payments.[29] As a result, the benefit to the debtor comes at the end of the loan term, long after the bankruptcy and, presumably, long after the debtor's financial exigency has ended, when the loan balance is prematurely paid in full. This long-term, deferred benefit is clearly not relevant to the debtor's need to "save his home" during the bankruptcy proceeding, and hence recognizing the § 1322(b)(2) limitation on home mortgage cramdowns does not impair homeownership.

Third, it is clear and unmistakable from the statutory language that Congress, surely cognizant of the points noted above, singled out residential liens for special protection from cramdown under § 1322(b)(2). If this special protection represents a "problem" for homeowners who would like to restructure their mortgage loans unilaterally every time there is a dip in the housing market, they should make this case to Congress instead of reinterpreting the Bankruptcy Code to find a new cramdown provision where none was intended.

Another alleged Chapter 13 *Dewsnup* "problem" is said to arise under Bankruptcy Code § 1325(a)(5)(B), which requires the debtor to pay the holder of an allowed secured claim the present value of that claim. Use of the language, "allowed secured claim," in

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[29] *See, e.g., Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176, 184 (2d Cir. 1992) (finding that "the terms of payment" must remain unchanged); *In re Brouse*, 110 B.R. 539, 544 n.7 (Bankr. D. Colo. 1990) (explaining that "the debtor is obligated to continue to pay the contract interest rate"); and *In re Demöff*, 109 B.R. 902, 916 (Bankr. N.D. Ind. 1989) (determining that debtors are only prevented "from changing the payment terms of claims").

§ 1325(a)(5) suggests a bifurcation of the claim, so that any plan modifying a secured claim under § 1322(b)(2) must also meet the test of § 1325(a)(5)(B) by preserving in the plan the time-value of the secured claim after cramdown. In this respect, § 1325(a)(5)(B) is the Chapter 13 equivalent of § 1129(b)(2)(A)(i)(I). Like the latter provision, § 1325(a)(5)(B) does not directly regulate the amount of the secured claim. After a cramdown is effected pursuant to § 1322(b)(2), the plan must preserve the present value of the crammed down lien over the life of the plan. In effect, this requires the payment of interest on the amount of the claim. Of course, a claim secured solely by a lien on the debtor's residence would not be subject to modification under § 1322(b)(2), and hence would involve no problems under § 1325(a)(5)(B).

Dewsnup's recognition of the lienor's *in rem* rights confirms that such liens flow through bankruptcy, unless modified pursuant to a Chapter 11, 12, or 13 plan, including a possible cramdown under §§ 1129(b), 1222(b)(2) or 1322(b)(2), in which case the lien flows through *as modified* and as additionally protected by §§ 1129(b)(2)(A)(i), 1225(a)(5)(B), or 1325(a)(5)(B). Nowhere in the statutory language is there anything to indicate that § 506(a) supersedes the § 524(a)(1) exclusion of liens from the effect of the bankruptcy discharge, outside the specific cramdown provisions cited above. Consequently, unless the lien is modified or restricted in a plan, the ultimate value of the lien will depend on the value of the property and may fluctuate as the property value changes over time. This is a fundamental characteristic of any *in rem* interest. *Dewsnup* again confirms this, noting that a lien stays with the property "until the foreclosure" and that this allows the creditor to benefit from any appreciation in value "during bankruptcy." *Dewsnup*, 112 S. Ct. at 778.

III. The Post-*Dewsnup* Case Law

A. The *Bellamy* Case Overlooks the Reasoning in *Dewsnup*

The first United States Court of Appeals case to consider Chapter 13 cramdowns after *Dewsnup* was *Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176 (2d Cir. 1992). In *Bellamy*, the bankruptcy court confirmed a plan modifying the home mortgage lien, and the district court affirmed. *In re Bellamy*, 122 B.R. 856 (Bankr. D. Conn. 1991), aff'd 132 B.R. 810 (D. Conn. 1991). On appeal to the United States Court of Appeals for the Second Circuit, the creditor argued that *Dewsnup* precludes the use of § 506(a) to cram down liens and that § 1322(b)(2) precludes modification of home mortgage liens in Chapter 13 cases.

The Second Circuit attempted to distinguish away the *Dewsnup* reasoning in this context, concluding that the mortgage lien protected by § 1322(b)(2) is only the secured portion of an undersecured claim as defined in § 506(a). In this way, the home mortgage lien could be crammed down under § 506(a) before the protective language at § 1322(b)(2), prohibiting modification of a home mortgage lien, takes effect. In the *Bellamy* view, the remaining effect of § 1322(b)(2) is to prohibit modification of the payment schedule as to the loan balance remaining after cramdown, so that the debtor must pay the full loan payments under the Chapter 13 plan, but receives a windfall in the distant future when the loan is paid off early. The *Bellamy* court specifically rejected the creditor's argument that § 1322(b)(2) protects home mortgage liens from modification.

The *Bellamy* court's conclusion that cramdown under § 506(a) does not constitute modification of the home mortgage lien because § 1322(b)(2) does not specifically refer to and override § 506(a), overlooks the basic role of § 506(a) as explained in *Dewsnup*.

Although *Dewsnup* did not specifically address the issue of home mortgage cramdowns in Chapter 13 cases, as that was not the issue before this Court, the reasoning in *Dewsnup* is clearly hostile to the use of § 506(a) to preempt the specific cramdown provisions of the Bankruptcy Code. The effort of the Second Circuit in *Bellamy* to meld §§ 506(a) and 1322(b)(2) together as part of a consistent statutory plan to allow cramdown of home mortgage debt under § 506(a), but not allow a reduction in the mortgage payments under § 1322(b)(2), is creative but indefensible in view of *Dewsnup*.[30]

B. Other Decisions Following *Bellamy*

In *Sapos v. Provident Institution of Savings in the Town of Boston*, 967 F.2d 918 (3d Cir. 1992), the United States Court of Appeals for the Third Circuit concluded that the *Dewsnup* rationale does not preclude cramdown of home mortgage liens in Chapter 13 cases. The *Sapos* decision is essentially a restatement of the Third Circuit's prior holdings before *Dewsnup*. Like *Bellamy*, *Sapos* ignores *Dewsnup's* rejection of the use of § 506(a) as a definitional or cramdown provision. As a result, *Bellamy* and *Sapos* are of no assistance in analyzing the impact of *Dewsnup* in Chapter 13 cases.

Similarly, in *Lomas Mortgage, USA v. Wiese*, 980 F.2d 1279 (9th Cir. 1992), the United States Court of Appeals for the Ninth Circuit dismissed *Dewsnup* as irrelevant to the use of § 506(a) in Chapter 13 cases, thereby ignoring the important lessons of *Dewsnup* in any lien-stripping case. Ironically, though perhaps not surprising, *Lomas* reaffirmed and relied on the prior

[30] The result is an interpretation that does not provide the debtor with relief from the obligation to make full payments during the course of the bankruptcy plan when the relief probably is most needed. This interpretation, however, does provide the debtor with a windfall in the form of a premature payoff of the reduced loan balance at a distant time in the future when the debtor may well be more affluent and the property may have increased considerably in value.

Ninth Circuit decision in *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989), which emphasized the bifurcation of claims under § 506(a). As noted above, however, that is not the issue here. The issue in this case is whether § 506(a) can be used to effect the modification of liens as *in rem* interests that otherwise flow through bankruptcy unaffected by the estate, bankruptcy claims, or the § 524(a) discharge.

Clearly, § 506(a) can be used to bifurcate claims into secured and unsecured portions for such purposes as participation in distributions of the estate to holders of unsecured claims. The language of *Hougland* and *Lomas* is consistent with accepted bankruptcy law on this point. It is quite another thing, however, to conclude that this converts § 506(a) into a master cramdown provision allowing modification of *in rem* interests that traditionally have flowed through bankruptcy.

Contrary to these cases, the legal and policy issues implicated by *Dewsnup* in the context of Chapter 11, 12, and 13 cases do not allow the use of § 506(a) to cram down secured debt prior to application of § 1322(b)(2). *Dewsnup* handled the tough question in a Chapter 7 case, where there is no specific cramdown provision to supplant, by concluding that § 506 cannot be used for this purpose. It seems even clearer that § 506 should not be used to supersede the comprehensive cramdown procedures in Chapters 11, 12, and 13. The courts in *Bellamy* and *Sapos* struggled with the clear implications of this, by concluding that § 1322(b)(2), which was obviously intended to prohibit cramdown of home mortgage liens,[31] instead allows it under § 506(a). Their struggle ignores and obscures other issues relating to statutory interpretation and the basic structure of the

[31] *See In re Chavez*, 117 B.R. 733, 736 (Bankr. S.D. Fla. 1990); *Matter of Kaczmarczyk*, 107 B.R. 200, 203 (Bankr. D. Neb. 1989).

Bankruptcy Code that should be more clear in the aftermath of *Dewsnup*. Not every court has been so preoccupied with resistance to *Dewsnup* to the detriment of other issues, however, as evidenced in the discussion below.

C. *In re Dyer* and the Proper Application of Section 506(a) in Chapter 13 Cases

Cases such as *In re Dyer*, 142 B.R. 364 (Bankr. D. Ariz. 1992), have had no difficulty following the *Dewsnup* reasoning in Chapter 13 cases to prohibit cramdown of home mortgage liens under §§ 506(a) and 1322(b)(2). The *Dyer* court reasoned that in Chapter 13 cases, § 506(a) is properly used only to determine secured or unsecured status for purposes of receiving payment under the Chapter 13 plan, and not to modify liens securing debts. In effect, § 506(a) bifurcation relates only to the debtor's personal liability and the creditor's claim against the estate, and does not affect any mortgage as an *in rem* lien. The sole basis for modifying liens in Chapter 13 cases is § 1322(b)(2), and home mortgage liens are exempted. As a result, a lien on the debtor's home can be extinguished only by payment, release, or mortgage foreclosure. The *Dyer* court noted that the *Dewsnup* opinion followed the holding in *Johnson v. Home State Bank*, 111 S. Ct. 2150 (1991), reconfirming that under § 524(a) only the debtor's personal liability is extinguished and liens flow through bankruptcy unless specifically modified, as under § 1322(b)(2).

The *Dyer* court pointed out that bifurcation of undersecured debt into secured and unsecured claims under § 506(a) does not alter the *in rem* nature of a mortgage lien. The *Dyer* court viewed this as being initially consistent with *Hougland*, which relied on § 506(a) to bifurcate the creditor's bankruptcy claim into secured and unsecured parts. However, *Dyer* then pointed out that bifurcation of the claim under § 506(a) should not affect retention of the creditor's lien

against the property, which flows through bankruptcy unless modified under § 506(d) or in Chapters 11, 12, or 13. Modification of the lien in Chapter 13 can only be accomplished through the specific cramdown provision at § 1322(b)(2), subject to the limitations of that provision. The *Dyer* court properly rejected the *Bellamy* rationale as being contrary to both *Johnson* and *Dewsnup*.

IV. Practical Implications of the Petitioners' Position

A. The Foreclosure Argument

The petitioners argue that allowing cramdown of home mortgage debt under § 506(a) in Chapter 13 cases would merely replicate the effect of a foreclosure, since a foreclosure would typically leave the lender holding property with the same value as the amount of the "crammed down" lien under § 506(a).[32] However, this reasoning is demonstrably incorrect.

When debtors abandon property to foreclosure, the secured creditors have the opportunity to purchase the collateral at the foreclosure sale at the current market price. Since such abandonments typically occur during periods of depressed real estate values, this permits creditors to realize any subsequent appreciation in the value of the collateral. Relinquishing this potential for appreciation has always been considered the price a debtor must pay for defaulting on the mortgage obligation in bankruptcy and, at the same time, a benefit that potentially mitigates the loss of the aggrieved lender. This has been an important part of the bargain for mortgage lenders since the beginning of federal bankruptcy law in the 19th century.

The prospect of foreclosure creates an important incentive against default on home mortgage loans

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[32] *See* the petitioners' brief, pps. 5-9.

which is a major factor in the relatively low default rate on loans secured by a debtor's home. This historical record in turn is responsible for the relatively low interest rates charged on consumer loans secured by the debtor's home. If debtors are instead allowed to reduce their home mortgage liens in Chapter 13 every time there is a dip in the market, the mortgage loan bargain will be rewritten into a very one-sided risk. If prices go up, the borrower wins. If prices go down, the lender takes the loss, while the borrower retains any subsequent upside potential. Imposition of such a result on mortgage lenders, in derogation of the contract terms and historical relationship between the parties, will inevitably result in an adjustment in future mortgage interest rates in order to compensate for this risk.

Lenders always have assumed some downside risk in such transactions. However, in the past there was consolation in knowing that a borrower who wanted to discharge home mortgage debt in bankruptcy would have to relinquish his or her home in the process, thereby yielding any subsequent appreciation in value. This has been an important constraint on abuse of the system, and an important consideration for mortgage lenders, as most borrowers traditionally have been hesitant to "walk away" from this important asset. If this constraint is to be removed, it will have immense consequences for all mortgage markets.

The enactment of the new Chapter 13 in 1978 represented a major change in the relationship between consumer debtors and secured parties, permitting consumer debtors to restructure debts as businesses do in Chapter 11, but without many of the creditor safeguards built into Chapter 11.[33] Section 1322(b)(2) was intended to protect home mortgage fi-

[33] *See In re Etchin*, 128 B.R. 662, 666 (Bankr. W.D. Wis. 1991).

nance from the dangers presented by this change.[34] The petitioners now seek to overturn this legislative and economic balance judicially. The revisionist use of § 506(a) to override the plain meaning of § 1322(b)(2) would deprive home mortgage lenders of any hope for recovery in a depressed real estate market. The practical result would be that only those with a very high net worth or surplus "disposable income," which can be accessed by creditors in Chapter 13 pursuant to Bankruptcy Code § 1325(b), or those able to make a huge downpayment would likely be deemed creditworthy for purposes of mortgage lending, since the collateral alone would no longer serve as a primary basis for the loan.

B. The *Amici* Argument

Apparently, in the *amici* view, § 506(a) would operate as the supreme cramdown provision in Chapters 11, 12, and 13, superseding the carefully crafted and more specific cramdown provisions in the reorganization chapters, while having no such effect in Chapter 7, the only chapter without its own comprehensive cramdown provision. This interpretation creates a fundamental conflict that strikes at the heart of the Bankruptcy Code reorganization structure and would convert Chapters 11, 12, and 13 into little more than a means of evading the *Dewsnup* limitations on the use of § 506(a) in Chapter 7 cases. The extensive cramdown provisions in Chapters 11, 12 and 13 would become merely a footnote to the real cramdown provision at § 506(a).

The examples used in the *amici* brief to illustrate the effect on subordinate mortgages of such a revision of the Bankruptcy Code's well crafted cramdown provisions mischaracterize the status of such mortgages in and out of bankruptcy. For instance, the example at

[34] *See id.*

pages 30-31 characterizes a third mortgage holder as "a completely unsecured creditor" because the value of the collateral is less than the balances owing on the two prior mortgages. The *amici* brief then concludes that wiping out the *in rem* lien of this third mortgage under § 506(a) would not impair the "economic reality" of the claim. However, this ignores the leverage provided by this lien, which must be paid before the homeowner will have clear title. As noted above, the holder of this subordinate mortgage may expect improvement in its position as a result of inflation in housing prices or payments on the prior loans. This is "economic reality." Indeed the *amici* brief makes very clear that impairment of this economic reality is precisely the purpose of the arguments asserted in that brief.[35] The *amici* conclude that "no unfairness" will result from depriving the creditor of this bargained for status, because the debtor will get a fresh start "free of [this] unjustified leverage."

The subordinate mortgage lien is not unfair and the resulting leverage is not unjustified. In any case, fairness and unjustified leverage are not bases for depriving a creditor of *in rem* lien rights in bankruptcy. The *amici* brief is, moreover, quite inconsistent on this point, arguing in one phrase that the leverage and potential value of a subordinate lien are "economically valueless," while in the same sentence arguing that release from this burden is essential to the debtor's fresh start.[36] Obviously, the resulting leverage has some value to the creditor or the debtor would not be so eager to eliminate it. It should also be obvious that this subordinate home mortgage was bargained for and agreed to by the debtor, typically in return for cash or other valuable consideration. It may

[35] *See* the *amici* brief, pps. 1-9 and 30-33.

[36] *See* the *amici* brief, p. 32.

be that the *amici* would like to see undersecured residential mortgage liens terminated on a *per se* basis in bankruptcy, but there is currently no such provision in the Code and the social judgments involved are clearly the province of the legislature, not the judiciary.

C. The Bankruptcy Discharge Argument

Despite arguments to the contrary,[37] giving effect to the home mortgage protections of § 1322(b)(2) will not allow creditors to circumvent the bankruptcy discharge. The bankruptcy discharge at § 524(a), by its terms, affects only the personal liability of the debtor. Such discharge precludes the home mortgage lien creditor from seeking recourse against the debtor or any property except that subject to the lien. The home mortgage lien creditor is entitled to share pro-rata in the distribution of the estate, pursuant to its unsecured claim as determined under § 506(a), and then is left with the lien on the real property, whatever its value. The possibility of an increase in property values or an improvement of position due to payments on prior liens provide real hope for a future recovery.

Contrary to the argument of the *amici*, this does not "allow the creditor to demand full payment with interest, even if the mortgage was, in real economic terms, totally worthless, despite the discharge."[38] Discharge of the debtor's personal liability precludes any demand for payment, unless the debtor wants the lien released. While the lien provides the lender some leverage and is therefore not "totally worthless", the debtor also has considerable leverage. The debtor's personal liability having been discharged, he or she can walk away from the property and leave it to foreclosure by the prior lienholder, thus extinguishing

[37] *See* the *amici* brief, pps. 33-39.

[38] *See* the *amici* brief, p. 34.

the subordinate lien. This delicate balance is a direct result of the bargain negotiated between the parties. The rights of the lien creditor, as one party to this bargain, should not be arbitrarily eliminated absent compelling evidence that Congress has intended to alter this relationship by expanding the bankruptcy discharge to cover *in rem* as well as *in personam* interests.

CONCLUSION

For the reasons set forth above, the decision of the court below should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM 1992

LEONARD NOBLEMAN, ET UX
Petitioner

v.

AMERICAN SAVINGS BANK,
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

MOTION FOR LEAVE TO FILE AND BRIEF OF NATIONSBANC MORTGAGE CORPORATION AMICUS CURIAE IN SUPPORT OF RESPONDENT

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Respondent

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE OF NATIONSBANC MORTGAGE CORPORATION

Amicus respectfully moves this Court for leave to file the attached brief.

Nationsbanc Mortgage Corporation is a nationwide mortgage originator and servicer having over two thousand employees in one hundred ten locations. The company now services nearly one-half million single family residential home loans having a value of over thirty billion dollars. Between June of 1991 and June of 1992 the company originated over fifty-four thousand mortgages and represented over thirteen hundred investors including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government

National Mortgage Association. As one of the nation's largest financial institutions, Nationsbanc is vitally affected by the issues before the Court.

The annexed brief argues that 11 U.S.C.A. 1322(b)(2) specifically provides that home mortgages may not be bifurcated into secured and unsecured portions.

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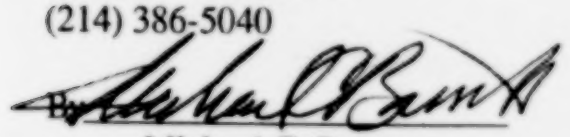
By: 
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INTEREST OF THE AMICUS

NationsBanc Mortgage Corporation ("Nationsbanc") is vitally interested in the result reached by the Supreme Court in the case at bar. The company's portfolio of home mortgage loans is extremely large and spread throughout the nation. Its interest in providing funding for single family home mortgage lending is dramatically affected when mortgages in one region of the nation are impacted by judicial positions which differ radically from those in other regions.

Further, Nationsbanc must consider the inherent risk associated with any lending activity in the light of the potential impact of the United States Bankruptcy Code. The current uncertainty renders risk underwriting in this area extremely difficult. Given the vastly different economic consequence between a reversal of the Fifth Circuit and an affirmance on the entire future underwriting process, Nationsbanc seeks to obtain a result which would continue to support the expansion and development of the American home loan industry and allow for the broadest and most inclusive underwriting criteria. An adverse result, overruling the Fifth Circuit, would, conversely, limit and restrict the underwriting process, and make residential mortgage lending a far more risk intensive pursuit.

Nationsbanc seeks to persuade this Court to hold in a manner which would promote the ability of the American mortgage industry to extend its services to the broadest possible portion of the population and to advance the principles of the National Housing Act which lie at the very core of American society.

SUMMARY OF ARGUMENT

NationsBanc Mortgage Corporation takes the position that a Chapter 13 Debtor should not be permitted to bifurcate a claim secured only by the principal residence into a secured and unsecured portion. In accordance with 11 U.S.C. Section 1322(b)(2), claims of this nature may not be modified. Bifurcation of claims secured only by the principle residence is inconsistent with the plain statutory language, standard principles of statutory construction and legislative history of section 1322(b)(2).

This Court's ruling in Dewsnup v. Timm compels a conclusion that Chapter 13 debtors cannot "cram down" a home mortgage loan. Further, this Court is compelled to construe and apply the United States Bankruptcy Code consistently with the National Housing Act.

ARGUMENT

I. THE PLAIN STATUTORY LANGUAGE, STANDARD PRINCIPLES OF STATUTORY CONSTRUCTION AND LEGISLATIVE HISTORY OF THE BANKRUPTCY CODE PROHIBIT BIFURCATION OF A CLAIM SECURED ONLY BY A SECURITY INTEREST IN REAL PROPERTY THAT IS THE DEBTOR'S PRINCIPAL RESIDENCE.

Bifurcation of a secured claim on real property that is the debtor's principal residence violates Section 1322(b)(2) of the Bankruptcy Code because: (1) the plain meaning of Section 1322(b)(2) prohibits such a modification; (2) principles of statutory construction dictate that secured claims held by a home mortgage lender not be modified; and (3) the legislative history confirms that claims secured by the principal residence may not be modified.

Modification of home mortgages clearly was not intended by Congress. A fair reading and interpretation of the statute and concomitant history lead to no other conclusion.

A. The Plain Meaning of Section 1322(b)(2) Precludes Bifurcation of a Claim Held by a Home Mortgage Lender.

Section 1322(b)(2) of Title 11 allows the Chapter 13 debtor's

plan to modify the rights of holders of secured claims, other than a claim secured by a security interest in real property that is the debtor's principal residence. The plain, clear meaning of Section 1322(b)(2) prohibits modification of a claim secured only by the principal residence. In United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 242 (1989), this Court held that "[t]he plain meaning of legislation should be conclusive except in the rare case [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters."

B. Principles of Statutory Construction Dictate that the Claim of a Home Mortgage Lender not be Bifurcated.

Section 1322(b)(2) of the Bankruptcy Code provides special protection for a lender that holds a claim secured by the Debtor's principal residence:

> Subject to Section (a) and (c) of this section, the plan may . . . (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of a claim;

11 U.S.C. Section 1322(b)(2) (emphasis added). The interpretation of Section 1322(b)(2) that is consistent with the plain language of the statute, with principles of statutory construction, with legislative history, and with the structure and purpose of the statute as a whole, affords protection to the entire amount of the debt owed to the home mortgage lender. This approach was applied by the Courts In re Russell, 93 B.R. 703 (D.N.D. 1988); In re Chavez, 117 B.R. 733 (Bankr. S.D. Fla. 1990); In re Sauber, 115 B.R. 197 (Bankr. D. Minn. 1990); In re Schum, 112 B.R. 159 (Bankr. N.D. Tex. 1990); In re Kaczmarczyk, 107 B.R. 200 (Bankr. D. Neb. 1989); In re Roberts, 99 B.R. 653 (Bankr. W.D. Pa. 1989); In re Catlin, 81 B.R. 522 (Bankr. D. Minn. 1987); In re Hynson, 66 B.R. 246 (Bankr. D.N.J. 1986); and In re Smith, 63 B.R. 15 (Bankr. D.N.J. 1986).

One of the primary tenets of statutory construction is that the words of the statute as "the primary, and ordinarily the most reliable, source of interpreting its meaning." In re Chavez, 117 B.R. 733, 735 (Bankr. S.D. Fla. 1990) (quoting Watt v. Alaska, 451 U.S. 259, 266 N.9 (1981). The language of Section 1322(b)(2) does not limit a creditor's protection to the rights relating to the secured portion of a residential mortgage. Instead, Section 1322 (b)(2) prohibits modification of any rights

of a "holder" of ...a claim secured by a security interest in real property that is the debtor's principle residence." 11 U.S.C. Section 1322(b)(2). As the Court in In re Catlin stated:

> It seems that many courts (and Colliers) have taken relatively simple straight - forward statutes and tortured them with overly complex (and in some cases perverse) analysis. In this Court's opinion, the proper judicial resolution of the issue lies in the disciplined application of statutes according to what they plainly mean.

81 B.R. 522, 527 (Bankr. D. Minn. 1987).

Applying the plain language of Section 1322(b)(2) would not make it inconsistent with Section 506 of the Bankruptcy Code. Section 506(a) states only that an allowed claim is a secured claim to the extent of the value of the creditors' collateral, and an unsecured claim to the extent that the claim exceeds the value. Section 506(a) does not purport to determine the creditors right to receive payment of its claim or the extent to which a creditors rights may be modified under the Plan. In re Simpkins 16 B.R. 956, 965 (Bankr. E.D. Tenn. 1982) (Section 506 does not determine the right to payment, but only whether a claim is secured or unsecured.) These matters are specifically provided for elsewhere in the Bankruptcy Code. See, e.g., 11 U.S.C. Section 1129(b)(2); and Section 1322(b)(2).

A second principal of statutory construction applies to demonstrate the absence of any apparent inconsistency between Section 1322(b)(2) and 506(a): "[g]eneral language of a statutory provision, although broad enough to include it, will not be held to apply to matters specifically dealt with in other parts of the same enactment." D. Ginsberg & Sons v. Popkin, 285 U.S. 204, 208, 52 S. Ct. 322, 76 L. Ed. 704 (1932). The structure of the Bankruptcy Code clearly shows that the specific language of Section 1322 is applicable to cases under Chapter 13, while Section 506(a) is a general provision which, thus, should be held not to apply.

> What the Hougland Court did not seem to appreciate, is that we are dealing with general and specific concepts that are intended to apply to, and govern, the rights of debtors and their creditors in different situations, and with different applications, depending upon particular code purposes to be served. The application of general concepts is not universal in the scheme of the Code, but is subject to specific limitation, and even total disregard, in some instances. Thus, the general definition of "secured claim" in Section 506(a), for instance, has no application to a creditor who has made an election under Section 1111(b) in connection with a Chapter 11 case.

In re Sauber, 115 B.R. 197, 199 (Bankr. D. Minn. 1990). Also,

in In re Mahaner, 34 B.R. 308 (Bankr. W.D.N.Y. 1983), the court held that Section 506(a) has no application under Chapter 7 where the debtor seeks to pay off the secured interest and redeem the property. A contrary interpretation would render Section 722 of the Bankruptcy Code, which provides for redemption for certain tangible personal property in Chapter 7 cases, mere surplusage.

C. The Legislative History of 11 U.S.C. Section 1322(b)(2) Confirms that Home Mortgage Lenders are Entitled to Protection of the Entire Amount of the Indebtedness.

Interpreting Section 1322(b)(2) so that it protects the entire amount of a residential mortgage lender's claim is mandated by the legislative history of that section. "It is clear that Congress intended special treatment for a creditor whose claim is secured only by a security interest in the Debtor's principal residence." In re Schum, 112 B.R. 159, 162 (Bankr. N.D. Tex. 1990). This "special treatment" was discussed at the time of the adoption of the current code. Under Chapter XIII of the Bankruptcy Act of 1898, the statutory predecessor of Chapter 13, an individual wage earner's reorganization plan could not "deal with" (i.e., modify or otherwise affect) the rights of any creditor holding a

claim secured by real property. The basis for this conclusion is that Chapter XIII of the 1898 Act expressly excluded from the definition of "claims" a "claim secured by estates in real property or chattels real." Bankruptcy Act of 1898, Pub. L. No. 61., 30 Stat. 544-66 (repealed 1978), Section 606(1); See In re Kaczmarczyk, 107 B.R. 200, 202-203 (Bankr. D. Nev. 1989).

In Grubbs v. Houston First American Savings Assn., 730 F.2d 236 (5th Cir. 1984), the Court noted that the original bill introduced into the House provided that a Plan may "modify the rights of holders of secured claims or of holders of unsecured claims..." 730 F.2d at 243. By contrast, the draft submitted by the Bankruptcy Commission (which formed the basis of the House bill) provided that the Plan:

> (2) may include provisions dealing with claims secured by personal property severally, on any terms, and may provide for the curing of defaults within a reasonable time and otherwise alter or modify the rights of the holders of such claims.
>
> ***
>
> (4) may include provisions for the curing of any default within a reasonable time and maintenance of payments while the case is pending on claims secured by the debtor's residence and on unsecured claims or claims

> secured by personal property on which the last payment is due after completion by the debtor of all payments under the plan.

Id. at 244. The Bankruptcy commission's explanatory note to clause 4 stated that the provision granted "a limited authority to deal with claims secured by a lien on the debtor's residence. Id.

Subsequently a Senate Subcommittee was convened to address the Senate version of the Bill. In hearings, witnesses for secured creditors appeared and objected to the provisions "that permitted reduction of the secured amount of the claim to the value of the collateral." Id. at 245 (citing Hearings Before the Subcommittee on Improvements of the Judicial Machinery of the Senate Committee on Judiciary, 95th Cong., 1st Sess. (1977)).

At the Senate hearings, Edward J. Kulik, Senior Vice President, Real Estate Division of Massachusetts Life Insurance Company, appeared as a witness. Mr. Kulik pointed out that the negative impact of "cram-downs" was of particular concern to real estate lenders:

> The proposed Chapter 13 [provision] in both bills, providing for the adjustment of debts of an individual with regular income, includes two fairly significant changes, compared to existing law, that may have the unintended

> effect of restricting the flow of home mortgage money.
>
> First, similar to the situation discussed previously in the commercial context, the holder of a mortgage on real estate may be forced to give up its specific security in return for some other property of uncertain value.
>
> Second, the stay of actions by the creditor protects not only the individual debtor under Chapter 13 but any guarantor or other codebtor as well.
>
> These provisions may cause residential mortgage lenders to be extraordinarily conservative in making loans in cases where the general financial resources of the individual borrower are not particularly strong.
>
> Serious consideration should be given to modifying both bills so that, at the least: one, a mortgage on real property other than investment property may not be modified, and two, providing that the stay of actions against a guarantor or other codebtor is applicable only to guarantees executed after the effective day of the new legislation.

Hearings Before the Subcommittee on Improvements of the Judicial Machinery of the Committee on the Judiciary, United States Senate, 95th Cong., 1st Sess. (1977), p. 714 (emphasis added).

Mr. Kulik's reference to changes from existing law included in "both bills" can be explained by the fact that the Senate bill (but not the House bill) contained the co-debtor stay provision that Mr. Kulik discussed.

The intent of Section 1322 (b)(2) must be derived by looking at the information before Congress when it passed the current version of Section 1322(b)(2).

The intent of this provision is explained in the joint explanatory statement agreed on by the House and Senate Floor Managers, published by each in the Congressional Record following the floor debates on the compromise bill:

> Section 1322(b)(2) of the House amendment represents a compromised agreement between similar provisions in the House bill and Senate amendment. Under the House amendment, the plan may modify the rights of holders of secured claims other than a claim secured by a security interest in real property that is the debtor's principal residence. It is intended that a claim secured by the debtor's principal residence may be treated under Section 1322(b)(5) of the house Amendment.

124 Cong. Rec. H32340 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S33989 (daily ed. Oct. 5, 1978) (statement of Sec. DeConcini).

The language of Section 1322(b)(2), as enacted, and its legislative history, clearly demonstrates that the intent of this section is to preserve the availability of residential mortgage funding for individuals of modest means by prohibiting any modification of the claims of residential mortgage lenders. The sole exception to this is the treatment expressly authorized by Section 1322(b)(5), which allows the curing of any default under a residential mortgage "within a reasonable time." 11 U.S.C. Section 1322(b)(5). Nowhere in the legislative history is there any suggestion that the statute, as finally enacted, was intended to permit a residential mortgage lender to be "crammed-down" to the appraised value of the collateral; indeed, this is exactly the type of modification of rights about which Mr. Kulik expressed concern, and which the compromise legislation was intended to prevent.

II. THE REASONING SUPPORTING THE COURT'S OPINION IN DEWSNUP V. TIMM COMPELS A CONCLUSION THAT BIFURCATION UNDER SECTION 1322(b)(2) IS IMPERMISSIBLE.

In Dewsnup v. Timm, ___U.S.___, 112 S.Ct. 773, 116 L.Ed.2d. 903, (1992), this Court denied a Chapter 7 debtor the

right to "strip-down" a creditor's lien by refusing to allow the debtor to use Section 506(d) to "redeem" real property by paying the secured creditor the current fair market value of the property. The debtor owed approximately $120,000 and the fair market value of the land securing the debt was judicially determined to be $39,000. The Supreme Court did not allow the debtor to use Section 506(a) and (d) to strip-down the value of the lien. The Dewsnup Court limited its holding to the facts of the case before it, though, because of the ambiguities between Section 506 and other provisions in the Bankruptcy Code. Dewsnup, 116 L.Ed. 2d at 910-911.

In Dewsnup, this Court recognized that historically "liens on real property pass through bankruptcy unaffected". Id. at 911. "Apart from reorganization proceedings, ... no provision of the pre-Code Statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt". Id. at 912. The absence of any legislative history expressing any intent to "grant a debtor the broad new remedy against allowed claims to the extent that they become 'unsecured' for purposes of Section 506(a) without the new remedy's [sic] being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, [to the Supreme Court], and

is contrary to basic bankruptcy principles." Id. at 913.

Although Dewsnup dealt with a Chapter 7 Debtor, the rationale is entirely applicable to a chapter 13 Debtor, as noted in one post-Dewsnup decision:

> [T]he United States Supreme Court decided a closely related question: it held that a debtor in Chapter 7 may not "strip-down" a creditor's lien on real property to the value of the collateral, as judicially determined, when that value is less than the amount of the claim secured by the lien . . . . Although the court deliberately refrained from deciding whether a debtor in Chapter 13 could do what the court held could not be done in Chapter 7 it is almost impossible to reconcile the decision's rationale with any different result in Chapter 13.

In re Strober; 136 B.R. 614 (Bankr. E.D.N.Y. 1992).

The Strober case combined the cases of two debtors who wished to strip the value of the liens on their principal residence to the fair market value. In denying the lien stripping, the Strober court recognized that "the authority of the decisions which have read Section 506 as limiting the protection given home mortgagees by Section 1322(b)(2) against cram down has been weakened, if not demolished by Dewsnup. . . ." Id. As in Dewsnup, the Strober court found little warrant "for attributing an intention to Congress to allow liens to be avoided in Chapter 13, to the extent that they become 'unsecured' for the purposes

of Section 506(a), when Chapter 13 contains an explicit prohibition against modification of a claim secured only by a security interest in real property that is the debtor's principal residence. 11 U.S.C. Section 1322(b)(2). The annals of Congress reveal that this explicit prohibition was crafted to block a debtor from voiding the mortgage on his home to the extent it becomes 'unsecured.'" Id.; See also In re Ireland, 137 B.R. 65 (Bankr. M.D. Fla. 1992) (held that a debtor may not bifurcate a lien secured by the principal residence in a Chapter 13 case because of the specific directive of Section 1322(b)(2)); Matter of Davidoff, 136 B.R. 567 (Bankr. M.D. Fla. 1992) (holding that Section 506 is applicable in Chapter 13 cases but is limited by the specific language of Section 1322(b)(2)).

The United States Supreme Court's opinion in Dewsnup and Grubbs v. Houston First American Savings Assn., 730 F.2d 236 (5th Cir. 1984), a leading opinion from the Fifth Circuit is consistent in the interpretation of the meaning of section 1322(b)(2). After a thorough analysis of the events surrounding the enactment of Section 1322(b)(2), the Fifth Circuit concluded that Congress intended to prohibit "cram-downs" of mortgages covering a debtor's principal residence:

> With regard to Section 1322(b)(2), the Senate receded from its position that no "modification" was to be permitted of any mortgage secured by real estate; it instead agreed to a provision that modification was to be barred only as to a claim "secured only by a security interest in real property that is the debtor's principal residence." This limited bar was apparently in response to perceptions, or to suggestions advanced in the legislative hearings . . . that, home mortgagor lenders, performing a valuable social service through their loans, needed special protection against modification thereof (i.e., reducing installment payments, secured valuations, etc.).

730 F.2d at 246 (emphasis in original).

The Grubbs Court was referring to Senate hearings held before the Subcommittee on Improvements of the Judicial Machinery of the Senate Committee on the Judiciary, 95th Cong., 1st Sess. (1977). During those hearings, various representatives of the mortgage banking industry testified regarding the negative impact modification of mortgages would have on their industry. After those hearings, the Senate made one amendment to the proposed version of Section 1322(b), allowing the plan to "modify the rights of holders of secured claims (other than claims wholly secured by mortgages on real property) or of holders of unsecured claims." Grubbs, supra, at n.14

(underlined text indicates content of the amendment); see also Hearings Before the Subcommittee on Improvements of the Judicial Machinery of the Committee on the Judiciary, United States Senate, 95th Cong. 1st Sess. (1977) p. 714. The version of Section 1322 (b)(2) that was finally enacted limited the Senate's proposed amendment to mortgages secured only by real property that is the debtor's principal residence.

III. BIFURCATION OF A HOME MORTGAGE LENDER'S CLAIM WILL RESULT IN A DIMINUTION OF THE AVAILABILITY OF RESIDENTIAL MORTGAGE FUNDING FOR INDIVIDUALS OF MODERATE MEANS.

The issue of housing for all individuals and families is of critical importance today. Congress has expressed its unwavering intent to provide housing for low and moderate income families. This intent is manifest in the programs that make federally insured mortgages available to individuals and families. Congressional concerns with housing issues are addressed by the National Housing Act. Under this Act, mortgage lenders have the added protection of federal insurance on the loans made pursuant thereto. If this Court were to hold that debtors can

cram-down a lien that secures the home mortgage, the entire structure of the federally insured mortgage program would be adversely altered. The Bankruptcy Code provisions should not be interpreted in a manner that would void the effect of the Act. No reported decision discusses the interrelationship of the National Housing Act with the Bankruptcy Code, nor have any courts utilized federal non-bankruptcy law as a tool to assist in the interpretation of the Bankruptcy Code. However, as the United States Supreme Court noted in Ruckelshaus v. Monsanto Co., 467 U.S. 986, 104 S. Ct. 2862, 81 L. Ed. 2d 815 (1984), where two statutes are capable of "co-existence, it is the duty of the Courts, absent a clearly expressed Congressional intention to the contrary, to regard each as effective." 104 S. Ct. at 2881 (quoting Regional Rail Reorganization Act Cases, 419 U.S. 102 133-134, 95 S. Ct. 335, 42 L. Ed. 2d 320 (1974) and Morton v. Mancari, 417 U.S. 535, 551 94 S. Ct. 2474, 41 L. Ed. 2d 290 (1974)).

"The Federal Housing Administration was established to encourage improvement in housing standards and conditions, to provide an adequate home financing system by insurance of housing mortgages and credit, and to exert a stabilizing influence on the mortgage market." 24 C.F.R. Section 200.3. In

order to carry out its directive, the FHA, an organizational unit within HUD, created the Federal Insurance program. The program provides a vehicle by which people of low and moderate incomes can purchase homes. Under the FHA insurance program, (the establishment and scope of the FHA is described at 24 C.F.R. 200.1, et. seq. The FHA insurance program appears at 24 C.F.R. 201.1, et. seq.), the obligation owed to the lender is essentially insured for the amount of the entire indebtedness by the FHA. If the mortgagor defaults on his obligation, the lender ultimately forecloses and conveys title to HUD. HUD then pays the balance of the outstanding indebtedness to the lender. Thus, the lender is assured of recovery, either through payment of the promissory note by the mortgagor or through a payoff by HUD under the FHA insurance. An adverse ruling would unravel the structure of the FHA program and, even under the most optimistic construction, significantly increase its costs. Under the current structure, a bifurcation and "cram down" destroys the protection of the insurance.

The legislative intent is clear in the National Housing Act: Congress obviously intended to provide adequate housing for low and moderate income families. However, the proper interpretation of 11 U.S.C. Section 1322 apparently is not

equally clear in that the courts are split in their interpretation of that bankruptcy code section. Therefore, under Ruckelshaus, this Court should look to the intent of the two Congressional enactments to determine a proper interpretation. Congress certainly would not provide with one hand a means by which credit would be made available under the National Housing Act and with the other hand remove that Act's effectiveness by taking away the inducement for mortgage lenders to participate in the federal insured loan programs. See Watt v. Alaska, 451 U.S. 259, 101 S. Ct. 1673, 68 L. Ed. 2d 80 (1981). There is no doubt that the cram-down phenomenon, in and of itself, takes away an important inducement for mortgage lenders to participate in the federal insured loan program. The judicial interpretation of 11 U.S.C. Section 1322 that permits cram-downs, therefore, drastically limits the effectiveness of the National Housing Act.

The clearly stated intent of the National Housing Act demonstrates that Congress intended to make housing available to low and moderate income families by inducing lenders to make home loans that they would not otherwise make. The inducement provided was Federal insurance. To interpret the Bankruptcy Code in a way that removes this inducement will nullify

a significant aspect of the National Housing Act in that lenders will be far less willing to participate in the absence of the protection of Federal insurance.

IV. CONCLUSION

For the foregoing reasons, this Honorable Supreme Court should hold that bifurcation of home mortgages is not permitted by section 1322(b)(2) and affirm the decisions of the courts below. Respectfully submitted,

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FOR ARGUMENT

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No. 92-641

In The
Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

On Writ of Certiorari
To The United States Court of Appeals
For the Fifth Circuit

AMICUS CURIAE BRIEF OF THE STATE OF ALASKA IN SUPPORT OF RESPONDENT AMERICAN SAVINGS BANK

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STATEMENT OF INTEREST OF AMICUS CURIAE STATE OF ALASKA

The State of Alaska's interest in the outcome of this case stems from its extensive investment in residential mortgages through various state agencies. These include the two principal state pension funds, the Public Employees' Retirement System and Teachers' Retirement System. The Permanent Fund Dividend Corporation, charged with the sound investment of a portion of Alaska's current oil revenues for the benefit of future generations, has also invested in residential mortgages, as has the Division of Investments within the State's General Fund.

But by far the largest portfolio of residential mortgages in Alaska is held by the Alaska Housing Finance Corporation (AHFC). AHFC is a public corporation

created by the Alaska Legislature in 1971 to remedy a serious shortage of decent residential housing in Alaska for persons of lower and moderate income. AS 18.56.010-.020. As of September 30, 1992, AHFC held 41,155 residential mortgages with a face value of over $3.2 billion, all on properties located within Alaska. Appendix, Exhibit "A."

Because of the cyclical nature of the Alaska economy, the values of the properties securing these loans may fluctuate widely, and some loans for a time may become undersecured during a downward fluctuation in property values. Such loans then become vulnerable to the type of stripdown rejected by the Court of Appeals for the Fifth Circuit in the present case, but upheld by the Court of Appeals for the Ninth Circuit in In re Hougland, 886 F.2d 1182 (9th Cir. 1989).

As a result of the Hougland decision, AHFC alone has lost nearly one million dollars from reductions of mortgage balances due to Chapter 13 stripdowns, and stands to lose more in the future if the practice is permitted to continue.

The State of Alaska therefore supports the position of respondent American Savings Bank in this case, and suggests affirmance of the Fifth Circuit's decision.

I. SUMMARY OF ARGUMENT

The State of Alaska is uniquely positioned to shed light on the issue before the Court, because Alaska has recently been through a period during which residential property values fell rapidly then recovered, and the low point of this cycle coincided with the approval of Chapter 13 stripdowns by the Ninth Circuit. The State of Alaska's experience

during this difficult time shows that Chapter 13 stripdowns primarily give a windfall to the debtor at the expense of the mortgagee and others, a result that Congress is unlikely to have intended.

The language of 11 U.S.C. Section 1322(b)(2) has been interpreted by various courts to permit stripdowns, but it can also readily be, and has been, interpreted to prohibit stripdowns. This ambiguity requires delving into the legislative history of the statute in order to determine Congressional intent. Historically, pre-Code practice did not permit mortgage stripdowns, although Chapter XIII debtors were permitted to cure defaults while maintaining payments. Witnesses before Congress testified against proposals to permit stripdowns. In response to this testimony, the statute took its current form. The only

explanatory comment on the final form of the statute indicates an intent to continue the pre-Code practice. There is no indication in the legislative history of any intent to depart from this practice to permit stripdowns on debtors' residences.

Interpreting the statute to permit stripdowns is also contrary to Congress's objectives in Chapter 13 and in the mortgagee clause of 11 U.S.C. Section 1322(b)(2). Permitting stripdowns eliminates any meaningful protection for mortgagees. At the same time, preventing modification of the mortgagee's other rights, although of no great benefit to the mortgagee, has the effect of reducing payments on unsecured claims and of actually making it more difficult for many debtors to keep their houses or propose a workable plan. Congress should not

readily be assumed to have intended such a result, when interpreting the statute to prohibit stripdowns does protect mortgagees, increases payments on unsecured claims, and does not significantly impact the debtor's fresh start or ability to propose a plan.

Finally, this Court's recent decision in Dewsnup v. Timm, -- U.S. --, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), that 11 U.S.C. Section 506(d) does not automatically operate to avoid the unsecured portion of a creditor's lien, also requires that 11 U.S.C. Section 1322(b)(2) be interpreted to prohibit residential mortgage stripdowns. Because the mortgagee's lien cannot be avoided under Section 506(d), some other lien avoidance power must be used, but no such power appears in Chapter 13. The power to "modify" the rights of creditors cannot be

read as including the power to avoid liens, and there is no evidence in the legislative history that Congress intended the section to contain a lien avoidance power. In the absence of a power to avoid the unsecured portion of the mortgagee's lien, the power to modify the mortgagee's rights in the unsecured portion of its claim is of little benefit to the debtor and is unlikely to have been intended by Congress.

II. ALASKA'S EXPERIENCE WITH CHAPTER 13 STRIPDOWNS.

A. Alaska's cyclical economy had a severe but transitory effect on property values and mortgage loans in the late 1980s.

As previously mentioned, Alaska's economy tends to be cyclical in nature. In the past 50 years there have been several periods of accelerated economic activity and expansion, followed by economic slowdowns and contractions of

greater or lesser severity: World War II, the discovery of oil in Cook Inlet in the 1950s, the discovery of oil on the North Slope in the 1960s, the construction of the Trans-Alaska Pipeline in the 1970s, and the oil boom of the early 1980s. Beginning in 1986, this last boom was followed by a severe economic downturn that reached bottom in approximately 1989. The population of the state declined. The Anchorage area, home to approximately half the State's people, lost almost 12% of its population. Appendix, Exhibit "B," page 2.

The downturn hit Anchorage particularly hard. One measure of this is property values. The values of single family homes tumbled an average 22.8% between 1986 and 1989, and condominium prices fell an average 65.9% over the same period. Exhibit "B," page 3. Because of

the concentration of population in the Anchorage area, the mortgage loan portfolios of AHFC and other state agencies were also concentrated in Anchorage properties.[1] The population exodus and decline in property values resulted in a soaring foreclosure rate. AHFC, for which figures are most readily available, had a loan portfolio of 51,969 loans, with balances totaling $4.3 billion, on June 30, 1986. Appendix, Exhibit "C," page 2. Over 60% of this was owed on properties in Anchorage, with over 75% owed on properties in Southcentral Alaska as a whole. Exhibit "C," page 3.

By December 1988, AHFC's loan portfolio had shrunk to 41,843 loans with

[1]With the exception of the Housing Assistance Division of the Alaska Department of Community and Regional Affairs, which specialized in rural loans. The Division was incorporated into AHFC in 1992.

total balances of $3.4 billion. Its inventory of foreclosed properties awaiting resale had reached 4,543 and over 13% of its loans were delinquent 30 days or more. Appendix, Exhibit "D," page 2. In 1986, AHFC took back 1,804 properties through foreclosure or repossession, 3,599 in 1987, 3,847 in 1988, and 3,035 in 1989. Appendix, Exhibit "E". Beginning in 1990, the economy began to improve, causing property values to recover. Single family home prices in Anchorage had returned to 92.2% of their 1986 peak by the end of 1991. Condominiums had regained over half the ground they had lost, recovering to 61.5% of their 1986 values. Exhibit "B," page 3.

B. Chapter 13 stripdowns became possible just as property values reached their low point, resulting in windfalls to some mortgagors.

However, some homeowners benefitted

more from this recovery than did others. In October 1989, as property values were at their lowest ebb, the Ninth Circuit's Hougland decision changed what had been the local interpretation of 11 U.S.C. Section 1322(b)(2)[2] and permitted Chapter 13 debtors to strip down their mortgage balances to the then-prevailing value of their residences. In the wave of Chapter 13 stripdown cases which followed the Hougland decision, the debtor-homeowners were able to reduce their mortgage balances to the depressed values of 1989 and early 1990, and reap the benefit of the appreciation which occurred later in 1990 and in 1991.

As a consequence, two homeowners who owned identical properties subject to

[2]Statutory references are to Title 11, United States Code, unless otherwise indicated.

identical mortgages in 1986 could be in very different situations by 1992, if one filed a Chapter 13 stripdown case in 1989 and the other did not. The homeowner who did not file bankruptcy would have seen a loss of value to 1989, then an increase in value back to near 1986 levels by 1992, with further appreciation likely in the future. In short, this homeowner would ultimately have been unaffected by the drop in property values: any "loss" was on paper only and would have been erased as property values recovered.

But the homeowner whose timing was good and filed a Chapter 13 stripdown case when property values were at their lowest ebb in 1989 would be much better off by 1992. That homeowner would be able to shift the paper loss to the mortgagee. For the mortgagee, the loss becomes an actual loss and not merely a paper one

because the stripdown means that the homeowner will no longer have to pay the mortgage in full. The later appreciation in value is irrelevant to the mortgagee. Even if the property value increases to a point where the property is again worth as much or more than the amount of the pre-stripdown mortgage balance, that appreciation will benefit only the debtor because the mortgage balance was limited to the earlier, lower, value of the property. Thus, through the magic of the Chapter 13 stripdown device, the homeowner is able to transmute a temporary loss in value into a permanent increase in the homeowner's equity in his or her residence. This increase in equity is made all the more pronounced by the more rapid amortization of the mortgage due to the reduction in its principal balance through the stripdown.

C. Chapter 13 stripdowns have had a significant impact, and may in the future have an even greater impact, on Alaska's mortgage loan portfolio.

The impact of Chapter 13 stripdowns on the state's loan portfolio has been significant. Again using figures for the AHFC portfolio, in just the 27 currently active Chapter 13 stripdown cases the loss has been over $900,000, not inclusive of the costs incurred in litigating the cases, for an average loss per case of $35,000. Appendix, Exhibit "F". The AHFC loan portfolio was particularly vulnerable to stripdowns, because AHFC had been the dominant residential mortgage lender in Alaska immediately before the downturn in property values. Borrowers on AHFC loans were, therefore, more likely to have purchased homes when values were at their peak and thus more likely to have little equity in those homes to cushion the

impact of the drop in property values. Appendix, Exhibit "G," page 2.

Because of this, it might be questioned why there are only 27 active stripdown cases affecting AHFC's portfolio of over 40,000 loans. Partly this is because many cases were attempted and failed due to the debtor's inability to either propose or adhere to a plan. The actual number of attempted stripdowns was much greater than 27. It would have been still greater had not AHFC and other mortgagees vigorously resisted stripdown cases. But the major reason for the relatively small number of stripdowns is the large number of foreclosures that occurred prior to October 1989, when the Ninth Circuit approved stripdowns in the Hougland case. The foreclosures which took place from 1986 to 1989 were generally against the properties which had

suffered the greatest decline in value relative to the mortgage balance, because default risk increases as the borrower's equity in the property becomes negative. Exhibit "G," page 2.

Had Hougland been decided in 1986, hundreds, possibly thousands, of Chapter 13 stripdown cases would likely have been filed in Alaska. Assuming a relatively conservative loss per case of $30,000, each 100 stripdown cases would have meant an additional $3,000,000 loss to the affected mortgagees. For AHFC, which finances its mortgage purchases through the sale of bonds, such a scenario would likely have resulted in a downgrading of its bond rating, forcing it to pay higher interest rates on future bond issues. This in turn would require AHFC to obtain higher interest rates on mortgages it purchased, thus undercutting AHFC's

mission to provide affordable housing. Additional difficulties would arise when the stripped down mortgage is paid off years early, forcing AHFC to find other sources of funds to maintain the payments to bondholders that previously had been funded by borrower mortgage payments. A similar problem would face state or other pension funds that had invested in mortgages that were later stripped down, because mortgage payments would not be available as expected to fund pension benefits. Consequently, one effect of Chapter 13 stripdowns is to benefit a small group of mortgagor-debtors today, at the expense of a larger group of potential homeowners, pensioners, and others, tomorrow.

D. Chapter 13 stripdowns result in a real loss to the mortgagee, even though it receives the value of the residence.

Because the Chapter 13 plan must provide a secured creditor with at least the value of its collateral, it might be argued that no real loss results to the mortgagee from the stripdown. Section 1325(a)(5)(B). There are several flaws in this argument. First, the argument assumes that the only alternative to the stripdown is a foreclosure by the mortgagee. While true in some cases, this would not be true in others. If the stripdown was not available, many mortgagors might choose to continue making mortgage payments and to not file bankruptcy at all, file a Chapter 7 bankruptcy and reaffirm on the mortgage debt, or file a Chapter 13 bankruptcy without modification of the mortgagee's rights, as was done before Hougland.

Second, even if the mortgagee does foreclose it may receive more than it

would have received under the Chapter 13 plan due to appreciation in the value of the property before it is ultimately sold. This right of the mortgagee to benefit from an increase in the value of its collateral was recognized in Dewsnup v. Timm, -- U.S. --, 112 S.Ct 773, 778, 116 L.Ed.2d 903 (1992). The mortgagee may also derive rental income from the property pending its disposition.

Third, in many cases the mortgagee would receive more than just the value of the residence if it foreclosed. Institutional lenders usually obtain mortgage insurance to protect themselves in the event of a decline in the value of their collateral. Such insurance may be legally mandated for any low downpayment loan. Under the Alaska Banking Code, no bank may make or acquire a mortgage loan with a loan-to-value ratio of over 90%

unless the loan is insured or guaranteed by a government agency or a private mortgage insurer. AS 06.05.207(a)(4) and (c). AHFC may not purchase a loan with a loan-to-value ratio over 80% unless the loan is the subject of private mortgage insurance, or a federal guaranty or federal insurance. 15 AAC 118.310(a)(3).[3] The Federal National Mortgage Association and Federal Home Loan Mortgage Corporation have similar restrictions under federal law. 12 U.S.C. Section 1717(b)(1) and (2); 12 U.S.C. Section 1454(a)(2).

Mortgage insurance is intended to satisfy all or a portion of the deficiency that results when the value of the mortgaged property is insufficient to satisfy the entire amount remaining on the mortgage at the time of foreclosure. In

[3]Recently recodified as 15 AAC 151.020(a)(3).

re Fischer, 126 B.R. 819, 823 at note 1 (D. Alaska 1992). In effect, the mortgage insurance substitutes for the large downpayment that would otherwise be required in order to give the mortgagee the protection of an equity "cushion" in the property. Fischer, at note 9. Approximately three-fourths of AHFC's loan portfolio has some kind of mortgage insurance coverage. Appendix, Exhibit "H," page 2.

Thus, in the event of foreclosure, AHFC or any other insured lender would receive more than merely the value of the property. However, the courts which have considered the issue have uniformly held that mortgage insurance is not to be taken into account in valuing the mortgagee's secured claim in Chapter 13 cases: The plan need only pay the mortgagee the value of the residence, without adjustment for-

the additional amount the mortgagee could recover through its mortgage insurance. Fischer, supra; Lomas Mortgage v. Wiese, 980 F.2d 1279 (9th Cir. 1992). At the same time, the insurance does not pay off in the absence of a foreclosure, which the bankruptcy prevents from taking place. A stripdown therefore represents a very real loss to an insured mortgagee even though the mortgagee will be paid the value of the residence itself over time.

The State of Alaska therefore regards the Chapter 13 stripdown device as merely giving a windfall to a few favored debtor-homeowners at the expense not only of the mortgagees whose rights are modified, but also of potential future homeowners who will be faced with higher interest rates or downpayment requirements as mortgage lenders take steps to protect themselves against possible stripdowns. Alaska's

cyclical economy and the coincidence that the Hougland case was decided just as the most recent cycle was reaching its low point put the State of Alaska in a unique position to demonstrate the effects of Chapter 13 stripdowns. The stripdown enables the debtor to lock in his or her mortgage balance at a temporarily depressed value, then reap the benefits as the economy improves, property values recover, and the mortgage pays off at an accelerated rate.[4] The mortgagee, on the other hand, is deprived of its right to benefit from any appreciation in value and is further deprived of the benefit of the mortgage insurance it obtained to protect it against any drop in value. The stripdown thus results in a real loss to

[4]For one measure of how much the debtors have benefitted, compare the "strip to" and "BOV" (Broker's Opinion of Value) columns of Exhibit F.

the residential mortgagee, despite its having been singled out by Congress for special protection. The State of Alaska therefore urges the Court to affirm the decision of the Fifth Circuit.

III. CONGRESS DID NOT INTEND TO PERMIT RESIDENTIAL MORTGAGE STRIPDOWNS IN CHAPTER 13.

A. The language of Section 1322(b)(2) may readily be interpreted to prohibit residential mortgage stripdowns.

Congress could, of course, have chosen to permit residential mortgage stripdowns in Chapter 13. The preceding discussion by the State of Alaska goes only to the wisdom of permitting stripdowns, and not to whether Congress might nonetheless have chosen to allow it. It has been said that Congress is not required to legislate wisely, only constitutionally. The constitutionality of depriving mortgagees of even the

unsecured portion of their mortgage lien was questioned by this court in Dewsnup, 112 S.Ct at 779. That aside, Congress should not readily be assumed to have legislated unwisely, and in a manner at odds with its obvious goals, as long as the legislation in question may be fairly interpreted in a way that avoids those objections.

Such is the case with Section 1322(b)(2). Many courts have held that the reference to "a claim secured by" the debtor's principal residence can only refer back to the preceding reference to "secured claims" in general, and therefore only the part of the claim secured by the residence--the "secured claim"--is immune from modification. E.g., Hougland, 886 F.2d at 1184. Other courts note that the definition of "claim" in Section 101(5)(A) refers to the entire claim, whether

secured or unsecured, that "claim" is used in the singular while "secured claims" is plural, and that what is modified are "the rights of holders of" claims, and not the claims themselves. Matter of Nobleman, 968 F.2d 483, 488 (5th Cir. 1992); In re Etchin, 128 B.R. 662, 668 (Bkrtcy. W.D. Wis. 1991). These courts hold that the statute prohibits residential mortgage stripdowns.

These contrasting positions of the courts, and not merely of the parties before the courts, demonstrate that at best the language of Section 1322(b)(2) is ambiguous. Dewsnup, 112 S.Ct at 777. This ambiguity requires examination of the legislative history of the statute.

B. The legislative history of Section 1322(b)(2) shows a clear intent to not depart from pre-Code practice that did not permit modification of a mortgagee's rights.

1. Under both former Chapter XIII and under the original proposed version of the Bankruptcy Code, the residential mortgagee's rights could not be modified.

Congress did not write on a clean slate when it enacted Chapter 13 as part of a new Bankruptcy Code in 1978. The former Bankruptcy Act had included a Chapter XIII since 1938, entitled Wage Earner's Plans. Report of the Commission on Bankruptcy Laws of the United States (Commission Report), Part I, page 157, reprinted in Collier on Bankruptcy, 15th ed., Appendix Volume 2. Under Chapter XIII, the plan could not "deal with," or modify, the rights of any creditor holding a claim secured by real property due to the exclusion of such claims from the Chapter XIII definition of claims. Commission Report, Part I, page 165. No

distinction appears to have been drawn between claims fully secured and those only partially secured.

Nonetheless, despite the formal inability of debtors to deal with real property secured claims in Chapter XIII, such claims were commonly dealt with on an informal basis. Courts sympathetic to the debtor facing the possible loss of his or her home would enjoin the creditor from foreclosing its mortgage while the case was pending, typically on the condition that payments be maintained and any default cured. Commission Report, Part I, page 165; Hallenbeck v. Penn Mutual Life Ins. Co., 323 F.2d 566 (4th Cir. 1963). Thus protected, the mortgagee would ultimately be paid in full.

With this procedural background, the Congressionally-authorized Commission on Bankruptcy Laws issued its report in 1973,

including a proposed new bankruptcy law ("Commission Bill"). The portion of this report and proposed law dealing with debtors with regular income became the foundation of the new Chapter 13.

This proposed provision, designated Chapter VI in the Commission Bill, incorporated several changes from the existing Chapter XIII that were designed to make it easier for debtors to deal with the claims of secured creditors. These changes and the rationale for them were discussed in the Commission Report:

> Accordingly, the Commission recommends that the new Act authorize inclusion in any plan proposed under Chapter VI, the successor to Chapter XIII of the present Act, provisions for the curing of defaults within a reasonable time and the maintenance of payments while the case is pending on claims secured by a lien on the debtor's residence and on claims secured by personal property on which the last payment is due after completion by the debtor

of all payments under the plan. With respect to short-term debts secured by personal property, the Commission recommends that the plan be permitted to include provisions dealing with such claims severally rather than generally as a member of a class of creditors. The proposal does not contemplate that the creditor so secured should be entitled to insist that the plan strictly preserve all of the terms of his original contract if the value of his claim against the property of the debtor is preserved. Commission Report, Part I, page 166 (emphasis supplied).

These recommendations were put into effect in the Commission Bill's version of Section 1322(b). This provision provided:

> Section 6-201. Provisions of Plan. A plan under this chapter may provide for a composition or an extension of indebtedness, or for a composition of some and an extension of other indebtedness and
>
> (1) shall include provisions dealing with unsecured claims generally, or by classes, on any terms, and may alter or modify the rights

> of the holders of such claims;
>
> (2) may include provisions dealing with claims secured by personal property severally, on any terms, and may provide for the curing of defaults within a reasonable time and otherwise alter or modify the rights of the holders of such claims;
>
> (3) may provide for payments on unsecured claims to be made concurrently with payments on claims secured by personal property;
>
> (4) may include provisions for the curing of defaults within a reasonable time and the maintenance of payments while the case is pending on claims secured by a lien on the debtor's residence and on unsecured claims or claims secured by personal property on which the last payment is due after

> completion by the debtor of all payments under the plan; . . . Commission Report, Part II, page 204 (emphasis in original).

Note that, like Chapter XIII, the Commission Bill did not generally allow a debtor to deal with claims secured by real property. The only exception was for claims secured by the debtor's residence. With respect to such claims and long-term debts secured by personal property, the debtor was granted the limited authority to cure defaults and maintain payments, a provision very similar to the practice that had developed under Chapter XIII. And, while the concept of bifurcation was explicitly recognized with respect to short-term debts secured by personal property, the Commission Report makes it clear that bifurcation was limited only to

such debts, and did not extend to long-term debts or those secured by the debtor's residence.

The Commission's Notes to Section 6-201 further underline this limitation by stating that "the secured claims referred to in this clause [clause (2)] and in clause (3) are only so much of the secured creditors' claims as do not exceed the value of their collateral." Commission Report, Part II, page 205, note 2. Conspicuously absent from this comment is a reference to clause (4) of Section 6-201, the provision specifically dealing with claims secured by the debtor's residence.

Thus, it is clear that under the Commission Bill the claim of a creditor secured by the debtor's residence was not to be bifurcated or modified in any way other than to allow the curing of

defaults. This is significant, because the Commission Report and Bill were highly influential in the formulation of the Bankruptcy Code, and the effect of this influence can be seen in the close parallels between Section 6-201 of the Commission Bill and Section 1322(b). Given the close parallels between the language of the two provisions, it is reasonable to suppose that there were also close parallels in the intended meaning of that language.

> 2. The process of adoption of the Bankruptcy Code shows an intent to continue the prohibition on modification of the mortgagee's rights contained in Chapter XIII and in the Commission Bill.

Despite the influence of the Commission Bill on the final version of Section 1322(b)(2), both the original

House and Senate versions would have permitted modification of at least undersecured claims secured by interests in real property, including the debtor's residence. The House version completely eliminated all protection by permitting the plan to "modify the rights of holders of secured claims or holders of unsecured claims." HR 8200, 95th Congress, 1st Session, Section 1322(b)(2). The Senate version limited the protection previously afforded under Chapter XIII to all real property secured claims to creditors with "claims secured wholly by mortgages on real property." S 2266, 95th Congress, 1st Session, Section 1322(b)(2) (emphasis added). The language of the Senate version is interesting, as it eliminates any question of bifurcation. As Section 506(a) defines secured claims, all such claims are necessarily "wholly" secured,

making the Senate's use of this term redundant unless the creditor's entire claim, in the Section 101(5)(A) sense, was meant.

However, neither of these versions became law, because residential mortgage lenders expressed concern about the impact of the proposed legislation on the availability of mortgage loans for individuals seeking to buy homes. In re Seidel, 752 F.2d 1382, 1385-6 (9th Cir. 1985); Grubbs v. Houston First American Savings Association, 730 F.2d 236, 245 (5th Cir. 1984). The State of Alaska is unaware of any testimony in favor of stripdowns, nor of any cases dealing with the stripdown issue that have cited such testimony.

While testimony before Congress might not ordinarily be considered legislative history, courts construing Section

1322(b)(2) have uniformly regarded this testimony as giving insight into what Congress intended in drafting the statute. See, e.g., Seidel, supra; Grubbs, supra; In re Glenn, 760 F.2d 1428, 1433-4 (6th Cir. 1985). Congress amended Chapter 13 by adding the mortgagee clause to Section 1322(b)(2). It is uniformly recognized by the courts that this amendment was in response to that testimony. Because that testimony opposed allowing stripdowns, the only logical conclusion is that the amendment to Section 1322(b)(2) was also intended to deal with the subject of cramdowns. Yet as interpreted by Hougland and the other courts permitting stripdowns, it does nothing of the kind.

Comparison of the proposed and final versions of Section 1322(b)(2) provides further proof that Congress was intending to prevent cramdowns as to residential

real property. The word "wholly" in the Senate version, which had the effect of restricting the non-modification protection to only fully secured claims, was dropped in favor of the word "only." The use of this word shows an intent to focus on the type rather than the amount of collateral, as a claim may be secured only by real property without being wholly secured by it. Further, the language of the final version shows an obvious kinship to the language of Commission Bill Section 6-201(4), which permitted only the cure of defaults on claims secured by the debtor's residence. The cure provision was carried into the Code in Section 1322(b)(5), and the purpose of the amendment and its relationship to the cure provision was explained in a joint comment by the floor managers of the Code:

> Section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate amendment. Under the House amendment, the plan may modify the rights of holders of secured claims other than a claim secured by a security interest in real property that is the debtor's principal residence. It is intended that a claim secured by the debtor's principal residence may be treated under § 1322(b)(5) of the House amendment. 124 Cong. Rec. H11107 (daily ed. September 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S17424 (daily ed. October 6, 1978) (statement of Sen. DeConcini) (emphasis added).

The floor comment makes it clear that, with respect to residential mortgages, Congress was adopting the approach of the Commission Bill and permitting only the curing of defaults and the maintenance of payments, and did not intend that the residential mortgagee's rights could be otherwise modified. The only plausible interpretation of the floor

comment is that the residential mortgagee's entire claim, rather than just its secured claim, was being taken out of Section 1322(b)(2) and placed within (b)(5). See Landmark Financial Services v. Hall, 918 F.2d 1150 (4th Cir. 1990) (cure under § 1322(b)(5) is distinct from cramdown under § 1322(b)(2), in that no modification of rights is permitted).

Thus, when the legislative history of the statute is studied in its entirety, it leads to the inescapable conclusion that Congress intended that the residential mortgagee's entire claim be protected. From the original Chapter XIII onwards, there is no indication that Congress ever considered a scheme for partial protection of a mortgagee's claim. Under both Chapter XIII and the Commission Bill, it was the mortgagee's entire claim that was protected. Under the original House

proposal no claim was to be protected, even if fully secured, and under the Senate proposal, only wholly secured claims were protected. There is no evidence of any proposal to Congress or debate by Congress of the hybrid approach of protecting only the secured claim but leaving the unsecured claim unprotected from modification. Because all of the evidence provided by the legislative history shows that Congress intended for the residential mortgagee to have protection for its entire claim and not merely its secured claim, and because there is no evidence of intent to provide only this partial protection, the State of Alaska feels that the result reached by the Fifth Circuit was correct and should be affirmed.

C. Permitting stripdowns under Section 1322(b)(2) actually eliminates the protection for

residential lenders that was intended by Congress.

> 1. In evaluating conflicting interpretations of the statute, it is necessary first to determine what purposes the statute was intended to serve.

The basic objectives of bankruptcy law are to achieve just and equitable distribution of assets to creditors and to relieve a debtor from the weight of oppressive indebtedness in order to give the debtor a "fresh start." In re Campbell, 124 B.R. 462, 464 (Bkrtcy. W.D. Pa. 1991); House Report ("HR") 95-595, p. 118, reprinted in Collier on Bankruptcy, 15th ed., App. Vol. 2. Within Chapter 13, the basic objective of distribution of the debtor's assets to creditors is modified by making sure that the creditors receive the value of those assets. Section 1325(a)(4) and (5). In addition to the

purpose of giving the debtor a fresh start, a specific goal of Chapter 13 is to enable the debtor to protect the debtor's assets, particularly the debtor's home. HR 95-595, p. 118.

However, Chapter 13 was not intended solely to benefit debtors. Chapter 13 was designed with an emphasis on debt repayment. In re Warren, 89 B.R. 87, 92 (9th Cir. BAP 1988) The legislative history notes that "the benefit to creditors [of Chapter 13] is self-evident: their losses will be significantly less than if their debtors opt for straight bankruptcy." HR 95-595, p. 118. Because secured creditors receive the benefit of their collateral in any case, the losses to which Congress was referring were those of unsecured creditors.

Finally, the specific purpose of the mortgagee clause of Section 1322(b)(2) was

to protect residential mortgage lenders and thereby assure that such lenders would continue to make loans on affordable terms. Glenn, 760 F.2d at 1433-4. Congress has on numerous occasions legislated in ways to encourage home ownership and to protect those who make home ownership possible. Congress has created secondary mortgage market agencies such as the Federal National Mortgage Association to purchase mortgages from primary lenders, spread the risk of those loans, and thereby reduce mortgage interest rates and downpayments to keep home ownership affordable. AHFC serves the same function in Alaska. The mortgage insurance program of the Department of Housing and Urban Development under 12 U.S.C. § 1709 and the guaranty program of the Department of Veterans' Affairs under 38 U.S.C. Section 1801 et seq. serve a

similar function. It is thus not surprising that Congress would include a specific provision in the Bankruptcy Code to protect residential mortgagees.

2. The pro-stripdown interpretation of the statute serves none of its purposes well, and is in conflict with many of them.

When the effect of interpreting the statute to permit stripdowns is measured against the various purposes of the statute identified above, it is clear that this interpretation conflicts with those purposes. In no case does it serve those purposes significantly better than the construction supported by the State of Alaska, and in most cases either serves those purposes significantly worse or actually runs counter to them.

The debtor's fresh start is not greatly aided by either construction. In

most cases, the debtor will still be making monthly mortgage payments long after the plan is completed, although they will go on longer if the mortgagee's rights are not modified. Nonetheless, the debtor's real fresh start comes from the discharge of other debts and not principally from the reduction of the mortgage balance. Bankruptcy law tends to look at the debtor's present financial condition and near-term rehabilitation. A benefit that the debtor will realize only several years in the future would not have weighed very heavily in the scales when Congress was drafting the Code.

The purpose of enabling the debtor to keep his or her residence is also not significantly better served by permitting stripdowns. The debtor must still cure any pre-preition default under Section 1322(b)(5), even if the amount of the

default is fully unsecured. Sapos v. Provident Institution of Savings, 967 F.2d 918, 927 (3rd Cir. 1992). Practically speaking, a mortgagee assured of full repayment because its rights cannot be modified is much more likely to work with the debtor to come up with a workable plan than is a mortgagee facing a loss because of the modification of its rights.

Moreover, if Congress's primary purpose was to enable the debtor to retain his or her home, including the mortgagee clause in § 1322(b)(2) was the wrong way to go about achieving this purpose. Because of the prohibition on modification of the mortgagee's rights, whether or not limited to its rights in its secured claim, the amount of the monthly mortgage payment cannot be reduced. Seidel, 752 F.2d at 1384-5. Typically, the monthly mortgage payment will be the largest

single expense in the debtor's budget. In many cases, the debtor's inability to modify the mortgagee's rights and lower the mortgage payment will prevent the debtor from proposing a feasible plan and assures that the debtor will in fact lose the house.

The pro-stripdown construction of the statute also conflicts with the purpose of reducing the losses of unsecured creditors. If the mortgagee's rights in the unsecured portion of its claim cannot be modified, so that the mortgagee must be paid in full, there will be no distributions to the mortgagee under the plan other than those necessary to cure any default under Section 1322(b)(5). All other plan payments can go to other unsecured creditors, thus maximizing their recovery. But if the mortgagee's rights can be modified, then the mortgagee's

unsecured claim must share in the distributions to unsecured creditors. As the mortgagee's unsecured claim may be a substantial portion of the total unsecured claims, this will greatly reduce the distributions to other unsecured creditors and thereby increase their losses over the situation where no modification of the mortgagee's rights is permitted.

Again, if a primary purpose of Congress in enacting Chapter 13 was to reduce the losses of unsecured creditors, including the mortgagee clause in § 1322(b)(2) was the wrong way to go about achieving this purpose as well. By preventing the monthly mortgage payment from being reduced, Congress reduced the amount of disposable income available to apply to the payment of unsecured claims, including the unsecured claim of the residential mortgagee. If it were not for

the mortgagee clause, the debtor would be able to reamortize the mortgagee's secured claim over the remaining life of the loan, thereby reducing the amount of the monthly mortgage payment. This would not only assist the debtor in the debtor's fresh start, but would free up additional disposable income to apply to the payment of unsecured claims, including that of the mortgagee. Thus, as interpreted by the cases finding in favor of stripdowns, Congress's use of the mortgagee clause is detrimental not only to the goal of increasing the payments to unsecured creditors, but to the goal of protecting the mortgagee as well.

This interpretation of the mortgagee clause conflicts with the purpose of protecting the mortgagee in other ways. By limiting the protection available to the residential mortgagee to the secured

portion of its claim, the practical effect of the this interpretation is to prevent only modification of the amount of the monthly mortgage payment and the interest rate on the loan. Neither of these protections is very useful, and in particular cases may actually be detrimental.

Prohibiting modification of the monthly payment amount is of limited benefit because the present value of the payment stream remains the same. On the other hand, prohibiting modification of the interest rate may put the mortgagee in a worse position than other secured creditors despite its "special protection." In general, the appropriate discount rate to use in determining the periodic payments to be made on a secured claim is the market rate of interest for comparable loans. In re Camino Real

Landscape Maintenance Contractors, 818 F.2d 1503, 1505 (9th Cir. 1987). Thus, the residential mortgagee will actually be treated worse than other secured creditors if the market rate of interest is higher than the contract rate of interest, because the mortgagee clause prohibits modification of the mortgagee's rights by increasing the rate of interest. This freezing of the rate of interest is a reasonable tradeoff when the mortgagee is being paid in full, but not when its rights in the unsecured portion of its claim are subject to modification.

Thus, it can hardly be said that interpreting the mortgagee clause to permit stripdowns offers the residential mortgagee any meaningful protection for its secured claim, let alone the "special protection" that was intended by Congress. A statute should not be interpreted so as

to render a part of it inoperative. In re Nobelman, 129 B.R. at 98 (N.D. Tex. 1991), and cases cited therein. Instead, it must be assumed that Congress worded Section 1322(b)(2) as it did to serve some purpose. In re Woodall, 123 B.R. 95, 98 (Bkrtcy. W.D. Okla. 1990). Interpreting the statute to permit stripdowns violates this precept by robbing the mortgagee clause of any purpose. When interpreted to permit stripdowns, the mortgagee clause provides only limited protection to the mortgagee and at the same time is detrimental to the other purposes of the statute. The payment to unsecured creditors is lessened, both because the unsecured portion of mortgagee's claim must share in distributions and because the mortgage payment may not be reduced. For the same reason, the debtor's ability to retain the residence is reduced and his

or her fresh start is impeded or at least not significantly assisted. In contrast, prohibiting modification of the mortgagee's rights in its entire claim not only does provide the intended special protection to the mortgagee but supports the other purposes of the statute as well. Payments to other unsecured creditors are increased, and the debtor's ability to retain the residence and achieve a fresh start are not significantly impacted, and may be improved.

In short, the only construction of the statute that is consistent both with its legislative history and with the recognized purposes of the statute is that supported by the State of Alaska. The State of Alaska therefore requests that this court affirm the decision of the Fifth Circuit.

IV. THIS COURT'S DEWSNUP DECISION IMPLICITLY REJECTS THE REASONING UPON WHICH HOUGLAND AND OTHER CASES PERMITTING STRIPDOWN ARE BASED.

A. Dewsnup held that Section 506(d) did not permit a stripdown in Chapter 7.

In Dewsnup v. Timm, 112 S.Ct. 773 (1992), the Court held that a Chapter 7 debtor could not make use of Section 506 to stripdown an undersecured creditor's lien to the value of the property securing the lien. Because Section 506 is relied upon in Hougland and other stripdown cases to permit an identical stripdown in Chapter 13, the reasoning of Dewsnup obviously has a bearing on whether those cases are correct.

In Dewsnup, the Court held that "Section 506(d) does not allow [the debtor] to 'strip down' [the creditor's] lien because [the creditor's] claim is secured by a lien and has been fully allowed pursuant to Section 502." 112

S.Ct. at 778. The Court reasoned that this would have been the result under pre-Code law, where a lien on real property passed through bankruptcy unaffected, apart from reorganization proceedings. 112 S.Ct. at 778-9 (citing former 11 U.S.C. § 616(1) and (10)). The Court further reasoned that Congress must have been aware of this practice when enacting the Bankruptcy Code in 1978. Because allowing lien stripdowns would have been a major change from pre-Code law, it should have been discussed in the Code's legislative history. In the absence of such a discussion, the Court ruled that to attribute to Congress an intention to make that change "is not plausible, in our view, and is contrary to basic bankruptcy principles." 112 S.Ct. at 779.

B. The reasoning of Dewsnup applies with equal force to stripdowns in Chapter 13.

The Court expressed no opinion as to whether the words "allowed secured claim" as used in Section 506(d) have the same meaning in other provisions of the Code. However, Section 506 is a provision of general application applicable to Chapter 13 as well as to Chapter 7 proceedings. Section 103(a); Hougland, 886 F.2d at 1183. Nothing in the Code suggests that Section 506(d) should have a different meaning in Chapter 13 than it does in Chapter 7, and normal rules of statutory construction require that it be given the same meaning. Sullivan v. Stroop, 496 U.S. 478, 110 S.Ct. 2499, 110 L.Ed.2d 438 (1990).

Further, just as with Chapter 7, there is no indication in the legislative history of Chapter 13 that Congress intended to effect a major change in pre-Code practice by permitting stripdowns on

the debtor's residence. As noted above, pre-Code practice did not permit the stripdown of liens on the debtor's residence in Chapter XIII. Allowing such stripdowns would be a major departure from pre-Code practice that should have been the subject of explicit discussion in the legislative history, according to Dewsnup.[5] In the absence of such discussion, the only conclusion that can be drawn is that no change from prior practice was intended by Congress. For this reason also, the Fifth Circuit should be affirmed.

C. No separate provision of Chapter 13 allows stripdowns.

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[5] The only explicit reference in the legislative history to the final version of Section 1322(b)(2) is the floor comment quoted in Part III.B. above, to the effect that claims secured by the debtor's residence were to be treated under the cure provisions of Section 1322(b)(5), which were adapted from the prior practice under Chapter XIII.

Because Section 506(d) must be interpreted the same way in Chapter 13 as in Chapter 7, the Dewsnup opinion means that Chapter 13 debtors may not rely on Section 506(d) in order to stripdown a mortgagee's lien to the value of the property securing the lien. In order for a stripdown to occur in Chapter 13, it must therefore be based on some other provision of the statute.

No explicit provision for the avoidance of liens appears in Chapter 13. The closest approach is the general power to modify "rights" contained in Section 1322(b)(2). However, this cannot be read as the equivalent of a power to modify liens. Where Congress intended for the debtor to have the power to modify or avoid liens, it provided that power explicitly, rather than leave it to implication. For example, Section 522(f)

gives the debtor the explicit power to avoid liens in certain exempt property.[6] Section 1123(a)(5)(E) provides that a Chapter 11 plan may provide for "the satisfaction or modification of any lien," a provision with no counterpart in Chapter 13.[7]

A Chapter 11 plan may also impair the rights of any class of claims. Section

[6] Section 522(f) is a provision of general application applicable in Chapter 13. It would entitle the debtor to avoid a judicial lien against the debtor's residence, as Section 1322(b)(2) protects only "security interests." The types of exempt property listed in Section 522(f) as subject to lien avoidance are consistent both with the approach of Commission Bill Section 6-201 (stripdowns only on short-term personal property secured claims) and the legislative history of the Code, which refers to stripdowns only of household goods and personal effects. HR 95-595, page 124.

[7] It was, however, taken directly from former 11 U.S.C. Section 616(10), which the Supreme Court in Dewsnup cited as an example of where stripdowns were permitted under the former Bankruptcy Act.

1123(b)(1). As defined in Section 1124, "impair" means essentially the same thing as "modify." Appeal of Capps, 836 F.2d 773, 776 (3rd Circuit 1987). If the power to impair or modify creditors' rights included the power to modify or avoid liens, the separate power to modify or satisfy liens contained in Section 1123(a)(5)(E) would be redundant. A statute should not be interpreted so as to render a portion of it superfluous. In re Oxborrow, 913 F.2d 751, 754 (9th Circuit 1990). Thus, a power to impair or modify a creditor's rights is something different from and does not include a power to avoid or modify a creditor's lien.

Because of this, Section 1322(b)(2) cannot be read as giving Chapter 13 debtors a power to avoid liens. That must be left to other provisions of the Code,

none of which are applicable here.[8] For this reason also, the Fifth Circuit should be affirmed.

V. CONCLUSION

While Alaska's recent experience with property value swings and stripdowns is unique, any state or region can be suddenly hit by severe local recessions that temporarily depress property values. Congress was aware of this in 1978 when it enacted the Bankruptcy Code. No logical reason exists for turning a temporary drop in value into a permanent windfall to the mortgagor-debtor and into a permanent loss

[8] This does not render Chapter 13 debtors powerless. Under Section 522(f), even oversecured liens may be avoided in a wide range of exempt property that covers practically everything the debtor owns other than house and car. A Chapter 13 bankruptcy is not a "reorganization" proceeding. In re Fischer, 136 B.R. 819 (D. Alaska 1992). Chapter 13 is only a vehicle for the adjustment of the debtor's debts, and a general power to avoid liens is not necessary to accomplish this goal.

to the mortgagee, and nothing in the legislative history of Section 1322(b)(2) suggests that Congress intended this result. Instead, the legislative history suggests that Congress intended to protect residential mortgagees by prohibiting stripdowns and continuing the pre-Code practice of permitting the debtor to cure defaults and maintain payments while the case was pending. This result is more consistent with the overall goals of Chapter 13 and of Congress's acknowledged objective in Section 1322(b)(2) of protecting mortgagees. Nor is there any evidence that Congress intended for there to be a general lien avoidance power in Section 1322(b)(2), and no other lien avoidance power could apply to the residential mortgagee's lien. For these reasons, the State of Alaska respectfully urges the Court to affirm the decision of

the Fifth Circuit in this case.

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APPENDIX

EXHIBIT A

ALASKA HOUSING FINANCE CORPORATION

STATISTICAL ABSTRACT

DATA BASE: AHFCMSTR-MINILIB POSTED TO 09/30/92

MORTGAGE LOANS BY SELLER SERVICER

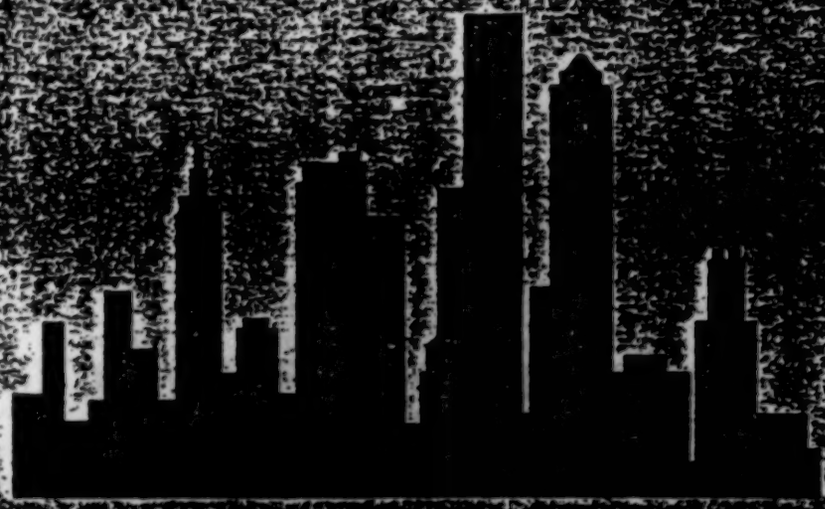
PERIOD ENDING:SEPTEMBER 30,1992

	NUMBER	AMOUNT
AHFC DIRECT SERVICING	40	$902,522.17
AHFC--REAL ESTATE HELD	673	11,270,780.58
ALASKA FEDERAL S & L *RHD	15	1,085,185.42
ALASKA FEDERAL SAVINGS & LOAN	904	71,678,925.12
ALASKA USA FEDERAL CR. UNION	8,341	625,389,448.16
ALASKA USA FEDERAL CU *RHD	128	14,275,231.02
BANK OF AMERICA	441	27,907,674.77
BANK OF AMERICA ALASKA	1,564	127,840,727.47
CENTRUST MORTGAGE CORPORATION	233	20,931,184.43
DENALI STATE BANK	218	17,907,756.41
FEDERAL DEPOSIT INSURANCE CO.	2	71,572.12
FIRST BANK	178	15,380,031.59
FIRST BANK *RHD	120	10,058,190.59
FIRST NATIONAL BANK OF ANCH	5,059	376,813,224.99
G.M.A.C. MORTGAGE CORP. OF PA	858	81,968,573.76
INTERIOR REGIONAL HSG. AUTH.	7	434,153.47
KEYCORP MORTGAGE, INC	3,305	246,646,412.22
KODIAK ISLAND HOUSING AUTH.	34	2,878,012.24
KODIAK ISLAND HOUSING AUTH*RHD	290	30,955,154.17
LOMAS & NETTLETON CO *RHD	6	417,547.89
MT MCKINLEY MUTIAL SAVINGS*RHD	1	14,540.84
MT. MCKINLEY MUTUAL SAVINGS	467	36,993,450.89
NANA REGIONAL HSG. AUTHORITY	19	1,339,418.29
NATIONAL BANK OF ALASKA	13,637	1,092,880,352.89
NATIONAL BANK OF ALASKA *RHD	805	80,271,179.94
NORTHRIM BANK *RHD	1	1,021,504.16
NORTHWEST INUPIAT HOUSING *RHD	1	55,586.05
PUGET SOUND	5	5,215,804.25
RURAL HOUSING DIVISION *RHD	1	100,000.00
SEATTLE MORTGAGE	319	28,133,393.80
SECURITY PACIFIC SAVINGS BANK	1	1,296,143.65
SOURCE ONE MTG SERVICES CORP.	2,827	216,982,857.16
TLINGIT-HAIDA REG. HOUS. AUTH	37	2,325,230.67
TLINGIT-HAIDA REGIONAL HSG*RHD	164	12,125,759.56
WESTERN MORTGAGE LOAN CORP.	118	11,380,651.87
1ST NATIONAL BANK OF ANCH *RHD	336	29,395,031.50
	41,155	$3,204,343,214.11

EXHIBIT B

Anchorage Indicators

1992 Update



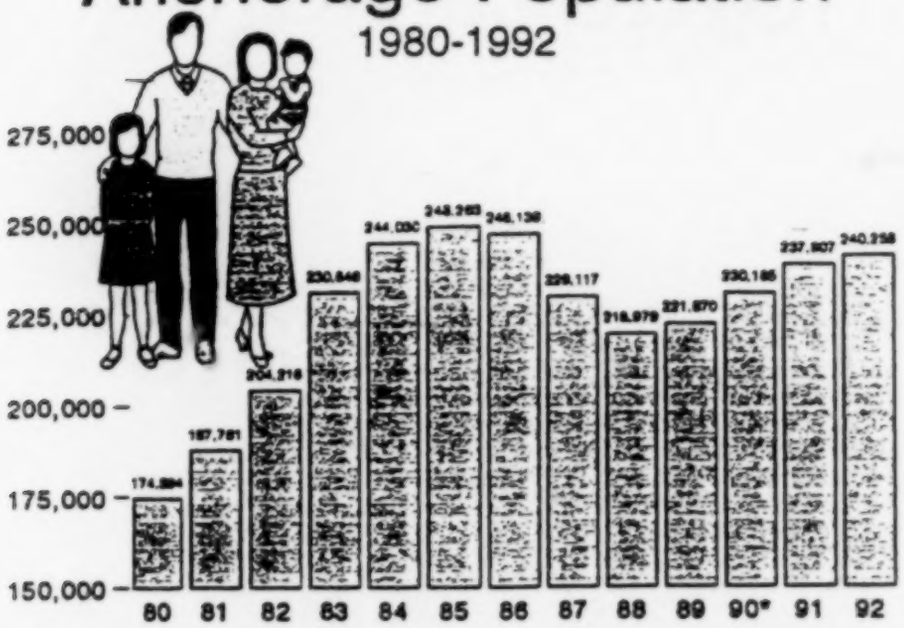
Prepared by Susan R. Fison, Manager, Research & Technical Services
Community Planning & Development Department, Municipality of Anchorage
P.O. Box 196650, Anchorage, Alaska 99519 Phone: (907) 343-4254 FAX: (907) 343-4254

Revised October 7, 1992

BEST AVAILABLE COPY

Anchorage Population

1980-1992



*Based on July 1 MOA survey; U.S. Census April 1, 1990 was 226,338.

Sources: 1980 based on U.S. Census; all others MOA Community Planning & Development estimates.

Year	Anchorage Population	Alaska Population	Anchorage % of State	Year	Anchorage Population	Alaska Population	Anchorage % of State
1929	2,736	59,278	4.6%	1978	177,817	384,100	46.3%
1939	4,229	72,524	5.8%	1976	179,837	409,800	43.9%
1950	30,060	128,643	23.4%	1977	182,920	418,000	43.8%
1960	82,833	226,167	36.6%	1978	180,248	411,800	43.8%
1961	89,299	236,669	37.7%	1979	174,584	413,700	42.2%
1962	90,149	242,817	37.1%	1980	174,431	401,851	43.4%
1963	93,885	249,904	37.6%	1981	187,781	433,800	43.3%
1964	94,519	253,204	37.3%	1982	204,216	466,200	43.8%
1965	102,337	266,192	38.6%	1983	230,848	497,800	46.4%
1966	105,925	271,505	39.0%	1984	244,030	522,000	46.7%
1967	107,817	277,906	38.8%	1985	248,263	539,600	46.0%
1968	113,522	284,880	39.8%	1986	246,136	547,600	44.9%
1969	114,180	294,560	38.8%	1987	229,117	537,800	42.6%
1970	126,385	302,361	41.8%	1988	218,979	531,000	41.2%
1971	135,777	319,600	42.5%	1989	221,870	534,400	41.5%
1972	144,218	329,600	43.7%	1990*	230,188	550,043	41.1%
1973	149,440	336,400	44.4%	1991	237,907	570,300	41.7%
1974	162,499	348,100	46.7%	1992	240,258	N/A	N/A

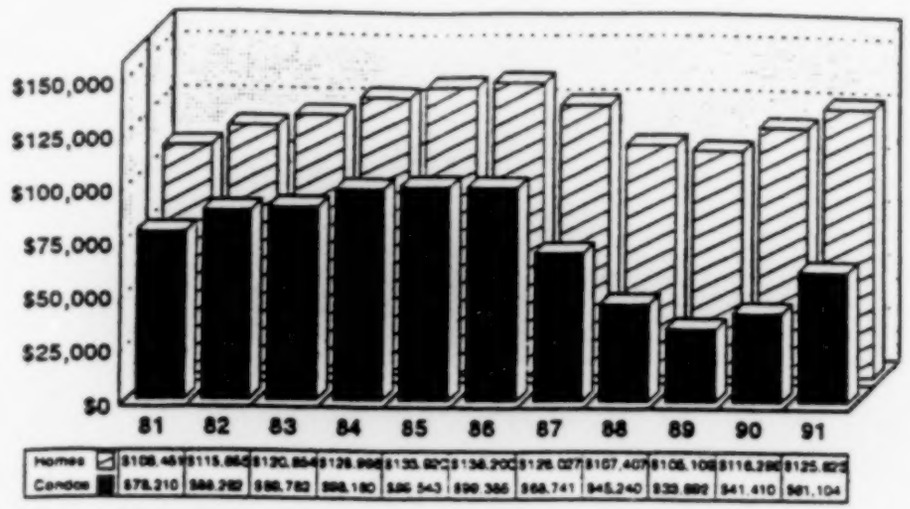
* This is based on a July 1, 1990 MOA survey. The April 1, 1990 Census counted 226,338 residents.
Source: Compiled by MOA Community Planning & Development Department from U.S. Census data, Alaska Department of Labor estimates and MOA estimates.

3 9095 00626415 9

Home & Condo Sales Prices

Anchorage

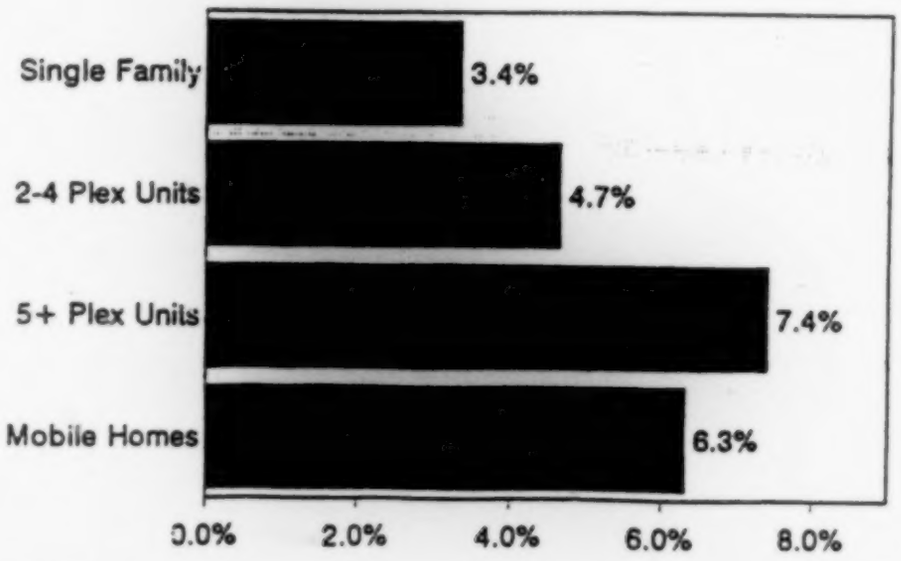
1981 to 1991



Source: Anchorage Multiple Listing Service.

Housing Vacancy Rates by Type

Anchorage (Except Turnagain Arm) 1992



Source: MOA Community Planning & Development Department survey.

EXHIBIT C

WHOLE EARTH CATALOG

July 1986

ALASKA HOUSING FINANCE CORPORATION

Selected Information

	Number	Amount
Loans owned at 6/30/86	51,969	$ 4,332,054,925
Outstanding loan commitments at 6/30/86	2,505	$ 292,069,227
Bonds outstanding at 7/31/86		$4,757,933,425

Delinquency Rates

	Mobile Homes	First Mortgage Loans	
	AHFC at 6/30/86	AHFC at 6/30/86	U.S. at 3/31/86 *
30 days	7.36%	4.70%	3.60%
60 days	3.26%	1.49%	0.96%
90 days or more and loans in foreclosure	4.89%	2.96%	1.88%
Total Delinquent and in Foreclosure	15.51%	9.15%	6.44%
Real Estate Owned	6.42%	1.33%	**

Budget Information

	Operating	Capital
Actual amounts Fiscal Year 1982	$2,276,200	$265,000,000
Actual amounts Fiscal Year 1983	3,441,000	150,000,000
Actual amounts Fiscal Year 1984	2,713,000(1)	49,051,000
Actual amounts Fiscal Year 1985	2,913,900(1)	
Approved budget Fiscal Year 1986	3,311,900(1)	

(1) Excludes trustee fees which are included in the capital budget.

* Delinquency statistics from the National Delinquency Survey published by the Mortgage Bankers Association.

** Statistics on real estate owned are not provided by the Mortgage Bankers Association.

ALASKA HOUSING FINANCE CORPORATION
MORTGAGES HELD BY CITY AND DISTRICT
JUNE 30, 1986

CITY	ACTIVE MORTGAGES	% OF MORTGAGES DISTRICT TOTALS	PRINCIPAL BALANCES	% OF DOLLARS
CRAIG	1,144	2.201	87,355,186.98	2.016
HOONAH	204	.393	10,802,551.12	.249
ELFIN COVE	664	1.278	51,222,933.14	1.182
JUNE BAY	3,513	6.760	286,810,245.63	6.621
CHITINA	712	1.370	48,323,048.83	1.115
PALMER	4,639	8.927	373,586,726.57	8.624
ANCHORAGE	30,215	58.142	2,617,765,664.87	60.428
ANCHOR POINT	2,743	5.278	206,705,600.60	4.772
KODIAK	720	1.385	53,895,541.08	1.244
SAND POINT	28	.054	2,085,014.60	.048
DILLINGHAM	50	.096	3,575,760.23	.083
ANIAK	175	.337	12,747,808.50	.294
GALENA	24	.046	2,189,800.28	.051
BETTLES AFB	229	.441	16,226,262.08	.375
ESTER	6,765	13.018	547,013,682.39	12.627
BARROW	81	.156	5,747,735.14	.133
NOME	62	.119	5,991,842.86	.138
		AREA TOTALS		
ANCHORAGE MUNICIPALITY	30,215	58.1415	$2,617,765,664.87	60.4279
MAT-SU VALLEY BOROUGH	4,602	8.8554	$371,176,993.09	8.5681
SOUTH CENTRAL ALASKA (EXCLUDING ANCHORAGE/MAT-SU)	4,489	8.6380	$331,932,307.60	7.6622
TOTAL SOUTH CENTRAL	39,306	75.62500	$3,320,874,965.56	76.65900
FAIRBANKS NORTH STAR BOROUGH	6,762	13.0118	$546,831,590.93	12.6229
NORTHERN ALASKA (EXCLUDING FAIRBANKS)	375	.7215	$28,147,931.74	.6497
TOTAL NORTHERN ALASKA	7,137	13.73400	$574,979,522.67	13.27300
JUNEAU BOROUGH	3,453	6.6444	$284,209,836.58	6.5606
SOUTHEAST ALASKA (EXCLUDING JUNEAU)	2,072	3.9870	$151,981,080.31	3.5082
TOTAL SOUTHEAST	5,525	10.63200	$436,190,916.89	10.06800
		TOTAL ALL LOANS		
TOTALS	51,968	100.000	$4,332,045,405.12	100.000

EXHIBIT D

Alaska Housing
FINANCE CORPORATION

STATISTICAL ABSTRACT

DECEMBER 1988

CSASUM

ALASKA HOUSING FINANCE CORPORATION

****

SELECTED INFORMATION FOR MONTH ENDING: 12/31/88

	NUMBER	%	DOLLAR	%
MORTGAGE LOANS	41,843	84.52	3,471,316,829	91.91
REAL ESTATE OWNED	4,543	9.18	271,805,544	7.20
INSURANCE RECEIVABLE	3,122	6.31	33,599,058	.89
TOTAL LOANS OWNED:	49,508	100.00	3,776,721,432	100.00

BONDS AND NOTES OUTSTANDING 3,851,109,339

DELINQUENCY STATISTICS, Mortgage Loans less Mobile Homes II: (2) (3)

Mortgage loans -				
30 days past due	1,740	4.44	152,568,233	4.50
60 days past due	679	1.73	61,279,400	1.81
90 days past due	445	1.14	38,955,748	1.15
120 days or more	2,288	5.84	210,786,055	6.22
TOTAL DELINQUENT LOANS:	5,152	13.15	463,589,437	13.67

OPERATING BUDGET:	1989 Fiscal Year	1988 Fiscal Year	1987 Fiscal Year
TOTAL BUDGET: (1)	5,924,100	5,801,200	3,741,900

(1) Budget excludes trustee fees and property maintenance, management and disposition costs associated with owned real estate and mobile homes. 1987 and 1988 are actual operating expenses; 1989 figures reflect the authorized budget.

(2) Delinquency rates include loans in foreclosure.

(3) Delinquency statistics are as percentage of Mortgage loans less Mobile Home II loans.

Note: Dollar figures calculated to penny accuracy, but printed in truncated dollars.

EXHIBIT E

YEAR		NUMBER OF FORECLOSURES/DIL*
1986		1,804
1987		3,599
1988		3,847
1989		3,035
1990		1,432
1991		519
1992		310
1993	(Through 2-4-93)	29
Total		14,575

Source is Alaska Housing Finance Corporation.

*DIL is for Deed in Lieu of Foreclosure.

EXHIBIT F

CONFIRMED AHFC CHAPTER 13 STRIPDOWNS

AHFC #	Original Note Date	Orig. Note Amount	Current Balance		Conf Date	Strip From	Strip To
6776	01/06/81	$75,000	$53,805		11/21/90	$67,745	$59,000
9527	05/31/83	$101,300	$23,735		06/21/90	$91,140	$47,633
29306	08/07/81	$57,000	$11,768	*	07/23/90	$51,978	$21,390
30506	09/01/81	$57,000	$29,062		10/31/91	$52,033	$32,000
39334	08/03/82	$76,950	$1,915		06/06/90	$71,971	$17,738
57767	01/12/84	$80,500	$30,469		02/15/91	$73,842	$43,500
66920	11/26/84	$96,750	$28,712		05/09/90	$92,749	$51,150
71760	07/29/85	$90,000	$25,746		04/11/90	$87,266	$46,000
71937	08/14/85	$99,000	$59,456		10/17/91	$92,371	$68,500
78122	07/08/86	$50,250	$0		01/23/90	$49,232	$9,500
105220	06/16/87	$110,000	$49,513		01/13/92	$105,208	$57,000
107702	04/07/88	$110,000	$45,403	*	03/09/90	$112,225	$60,351
107721	04/08/88	$105,000	$45,525	*	01/25/91	$110,201	$56,730
107907	04/21/88	$130,450	$83,507	*	09/13/90	$132,284	$98,000
108954	06/01/88	$75,000	$74,290		03/15/90	$75,933	$33,000
110782	09/19/88	$121,450	$93,556	*	03/19/90	$120,533	$102,000
112354	11/07/88	$74,200	$22,047		02/27/90	$73,787	$34,410
113451	11/04/88	$58,750	$12,742		05/22/90	$57,359	$24,680
114909	12/07/88	$102,100	$39,345		05/06/91	$100,794	$49,290
115195	09/14/88	$75,950	$18,956	*	07/11/90	$77,989	$32,550
115704	08/01/88	$109,250	$48,300	*	10/19/90	$116,044	$63,142
115708	09/01/88	$146,300	$97,464		06/90	$148,682	$112,000
117624	03/09/89	$104,000	$68,151		09/14/90	$102,388	$75,622
117036	01/31/89	$113,750	$108,899		12/18/91	$110,646	$80,000
118102	01/26/89	$118,450	$114,427		08/12/92	$114,736	$98,000
118525	11/29/88	$140,000	$111,487	*	06/11/90	$145,434	$120,900
121215	01/06/89	$90,700	$85,159		01/20/93	$85,159	$56,600
Totals		$2,569,100	$1,383,439			$2,519,729	$1,550,686

* AHFC notification date as actual confirmation date is unavailable due to time on at this time.

CONFIRMED AHFC CHAPTER 13 STRIPDOWNS

Strip From	Strip To	Strip Amount	Appraised @ Conf	Pre-HOAP Note Date	Note Amount	BOV** a/o 1/14/93
$67,745	$59,000	$8,745	$61,000			$89,500
$91,140	$47,633	$43,507	$52,000			$77,000
$51,978	$21,390	$30,588				$32,500
$52,033	$32,000	$20,033	$32,000			$37,000
$71,971	$17,738	$54,233	$18,321			$36,000
$73,842	$43,500	$30,342	$40,000			$67,500
$92,749	$51,150	$41,599	$55,000			$85,000
$87,266	$46,000	$41,266	$38,000			$68,000
$92,371	$68,500	$23,871	$68,500			$61,000
$49,232	$9,500	$39,732	$9,500			$19,500
$105,208	$57,000	$48,208	$57,000			$70,000
$112,225	$60,351	$51,874		06/15/84		$95,000
$110,201	$56,730	$53,471	$56,730	02/04/85		$80,000
$132,284	$98,000	$34,284	$98,000	12/13/83		$124,000
$75,933	$33,000	$42,933	$33,000	05/16/85		$49,000
$120,533	$102,000	$18,533	$102,000	01/21/83	$127,000	$105,000
$73,787	$34,410	$39,377		03/27/84	$75,000	$61,000
$57,359	$24,680	$32,679		01/19/83	$61,750	$33,000
$100,794	$49,290	$51,504	$50,000	11/29/82	$107,350	$73,000
$77,989	$32,550	$45,439	$35,000	08/10/83		$54,900
$116,044	$63,142	$52,902	$72,000	10/05/84		$93,350
$148,682	$112,000	$36,682	$112,000	08/05/86		$131,000
$102,388	$75,622	$26,766	$77,000	04/03/85	$100,000	$101,000
$110,646	$80,000	$30,646	$80,000	07/11/84	$115,600	$78,000
$114,736	$98,000	$16,736	$98,000	12/14/83	$119,200	$92,000
$145,434	$120,900	$24,534	$130,000	07/13/83		$145,000
$85,159	$56,600	$28,559	$51,000	11/08/83	$91,500	Added 2/4/93
$2,519,729	$1,550,686	$969,043				$1,958,250

EXHIBIT G

RECEIVED
APR 06 1987

ISER RESEARCH SUMMARY

Institute of Social and Economic Research, University of Alaska, Anchorage November 1986, R.S. No. 32

AHFC's Market Effects, 1980–1986

If you moved out of a rented apartment and bought a house in Alaska during the past six years, or if you bought a bigger or better house than you owned before, chances are good the Alaska Housing Finance Corporation (AHFC) subsidized your mortgage interest rate or offered you other special loan terms. AHFC financed 80 percent of new Alaska mortgages in the 1980s.

A recent study by the University of Alaska, Anchorage's Institute of Social and Economic Research (ISER) found that between 1980 and mid-1986 AHFC's programs allowed Alaskans to buy *more* and *better* houses: about 8,000 households that would otherwise have rented were able to buy; roughly 11,000 households that would otherwise have bought condominiums or mobile homes were able to buy single-family houses; and overall, the roughly 58,000 Alaska households that bought through AHFC spent about 15 to 20 percent more (buying bigger or better houses). Figure 1 illustrates some of the effects of AHFC on Alaska's housing quality.

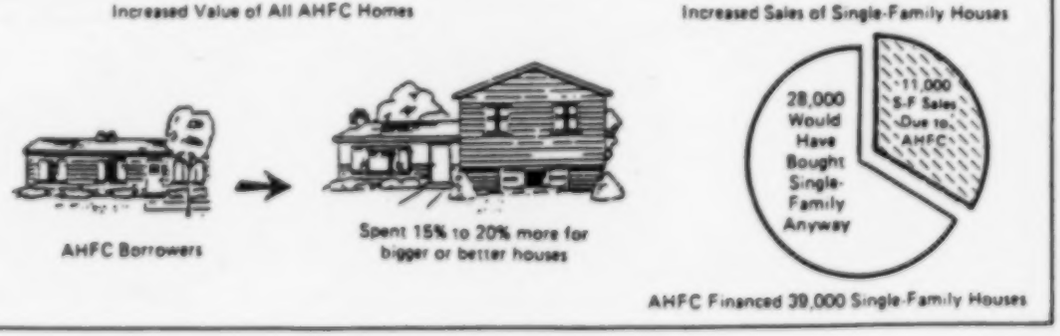
But did AHFC's subsidized interest rates and other policies designed to help more Alaskans buy homes also drive up prices? Are AHFC's loan policies in part responsible for the growing number of mortgage defaults, now that Alaska's economy is in a slump? And how much demand might there be for AHFC mortgages in the coming years?

The ISER study—done for AHFC—broadly examines how AHFC's residential mortgage loan programs have affected the Alaska housing market in the 1980s, and includes a model to project future mortgage demand.

Finding Highlights

- The biggest effects of AHFC's programs have been on the number and quality of houses sold rather than on prices, as noted above.
- Sales of just single-family houses were 40 percent higher in the first half of the 1980s, largely as a result of AHFC policies that allowed a substantial number of Alaskans who would otherwise have bought condominiums or mobile homes to buy single-family houses.
- AHFC's programs have had little *lasting* effect on prices: they increased prices by about 3 percent above what they would otherwise have been in the first half of the 1980s. AHFC's interest subsidies did contribute to the sharp price increase in the early 1980s, because those subsidies rapidly increased demand. But higher prices stimulated new construction that rapidly increased the supply of housing and held down subsequent price increases.
- The high conventional mortgage rates prevailing at the start of the 1980s might have reduced the share of Alaska households owning their own homes by as much as 12 percent if AHFC had not subsidized rates.

Figure 1. Selected Effects of AHFC on Alaska Housing Quality, 1980-1986

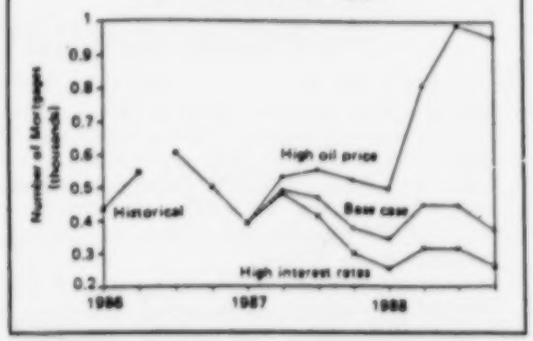


- Homeowners tend to default on their mortgages when prices of their homes fall below what they still owe on the properties. The overall housing boom of the early 1980s and AHFC's programs sharply increased the number of Alaskans owning their own homes—so that many more households were at risk when the economic downturn brought down housing prices.
- Homeowners with little equity in their properties are more likely to default on their mortgages than are others with similar family and financial characteristics. AHFC has been harder hit by defaults than other lenders because many AHFC mortgage holders have little equity in their properties. AHFC made about 80 percent of new mortgage loans in the past few years—so thousands of AHFC borrowers have had little time to build up equity. Also, AHFC requires smaller down payments than do other lenders.
- AHFC borrowers with mortgages on condominiums and mobile homes have been more likely to default because prices of condominiums and mobile homes have fallen more—in percentages—than have prices of single-family houses. When housing prices are falling, single-family houses tend to hold their value better than do condominiums or mobile homes, because buyers generally prefer single-family houses and are better able to afford them when prices are down.
- AHFC programs, by continuing to offer the lowest available interest rates and other benefits, are still—even in the current economic slump—stimulating more demand for housing than would exist without the programs.

Projected Mortgage Demand

The computer model ISER developed for this study projects that in the absence of any big economic changes, demand for new AHFC mortgages will change little through the end of 1988—so while the housing market will remain slow, the slump in prices and sales is not likely to get much worse than it already is. However, defaults and foreclosures will probably continue to rise.* But projections of any sort are very risky in the uncertain economic climate in Alaska in 1986, and mortgage demand is very sensitive to changing economic conditions. Figure 2 illustrates the possible range of demand for new AHFC mortgages quarterly through 1988, under different economic assumptions.

Figure 2. Projected AHFC Loans Under Three Economic Scenarios
(New Conventional First Mortgages)



The middle line shows projected mortgage demand under the assumptions in the model's base case; the base case assumes that oil prices will stabilize slightly above their current levels and that per capita income and employment will decline slightly. The bottom line shows how mortgage demand could fall if interest rates rose to 14 percent; if that happened, mortgage demand could drop substantially below 1986 levels. The top line shows how mortgage demand could surge to twice the current levels if the price of oil increased substantially and alleviated the economic slump. There are many other factors that could affect mortgage demand; the ones in the figure are just intended to show the range of possible activity.

*We assume that AHFC will not auction off its large and growing inventory of foreclosed and repossessed homes. If auction-type sales (such as the one FNMA recently held in Anchorage to reduce its inventory of foreclosed homes) became more prevalent, prices would fall much more rapidly in the short-term and bottom out more quickly.

This summary is based on **Effects of Changes in the Alaska Housing Finance Corporation Mortgage Programs** *by Matthew Berman and Lee Huskey. The 130-page report is available for 10 cents a page from ISER at 3211 Providence Drive on the UAA campus; phone 786-7710.*

RESEARCH SUMMARY (No. 32)
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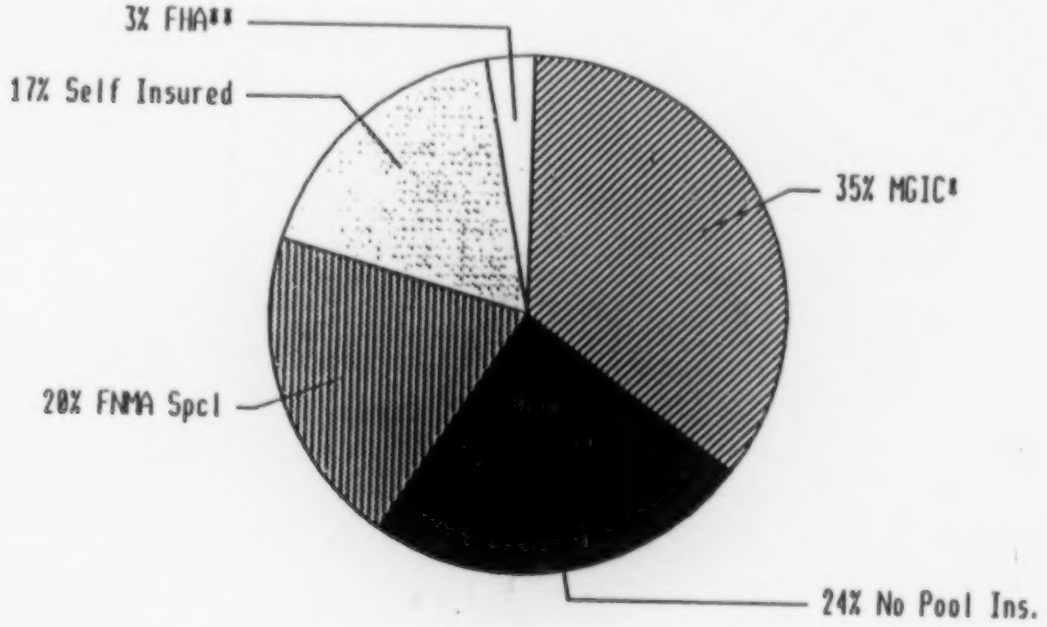
EXHIBIT H

Alaska Housing
FINANCE CORPORATION

STATISTICAL ABSTRACT

June 1988

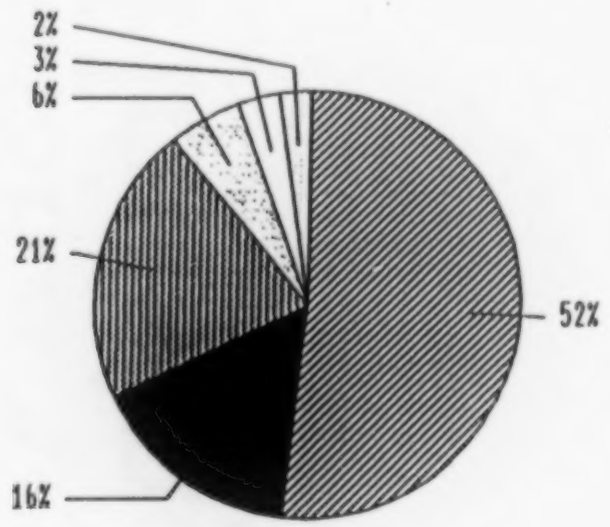
Pool Coverage of Loan Portfolio
June 1988



* Including FHA & VA

** Excluding MGIC

Primary Insurance Coverage of Loan Portfolio
June, 1988



Total Portfolio

PMI VA LTVR<=80% LTVR>80% FHA Unidentified